

Funding for the Future? Lessons from the Past

A Review of USAID Dollar-Appropriated Endowments

Amy Javaid
Diana Escueta
Robert Bonardi
February 2002



COMMERCIAL MARKET STRATEGIES
NEW DIRECTIONS IN REPRODUCTIVE HEALTH

*Funding for the Future? Lessons From the Past:
A Review of USAID Dollar-Appropriated Endowments*

Amy Javaid
Diana Escueta
Robert Bonardi



CONFIDENTIALITY

Accuracy and comprehensive access to source information to produce this report required review of internal documents and interviews with key individuals from the United States Agency for International Development (USAID) and the endowment recipient organizations. Some of the information contained in the documents, and discussed in the interviews, is confidential and subject to a confidentiality agreement signed by the Commercial Market Strategies (CMS) review team. All confidential information has been excluded for purposes of this report.



In partnership with:
Abt Associates, Inc.
Population Services International

OCCASIONAL PAPER SERIES

CMS's Occasional Paper Series addresses important issues relating to the private sector's role in reproductive health and family planning. Papers in the series may discuss lessons learned and best practices, highlighting CMS technical areas and country program operations.

THIS PUBLICATION FINANCED BY USAID



This publication was made possible through support provided by the Bureau of Global Health, Office of Population and Reproductive Health, United States Agency for International Development (USAID) under the terms of Contract No. HRN-C-00-98-00039-00. The views and opinions of authors expressed herein do not necessarily state or reflect those of USAID or the US Government.

ADDITIONAL COPIES

Commercial Market Strategies Project
1001 G Street NW, Suite 400W
Washington, DC 20001-4545

Tel: (202) 220-2150
E-mail: info@cmsproject.com

DOWNLOAD

Download copies of CMS publications at:
www.cmsproject.com.

ABOUT THE AUTHORS

All of the authors work in the Health Care Practice Unit of Deloitte Touche Tohmatsu's Emerging Markets Group. Amy Javaid provides technical assistance to multiple USAID-funded activities, including the CMS project. Ms. Javaid has worked with many NGOs on issues of sustainability, innovative and long-term financing mechanisms, management, and governance. Diana Escueta provides operations and research support to the CMS project. Ms. Escueta also worked on several endowment efforts that were implemented under USAID's PROFIT project (1991–97). Robert Bonardi is the Director of the CMS project. He also has significant experience with endowments from the PROFIT project, as well as with a number of innovative financing mechanisms implemented under CMS.

ACKNOWLEDGMENTS

Thanks to Bob Siegel from USAID/PPC; Shyami DeSilva and Marguerite Farrell at USAID; Carlos Carrazana from the Summa Foundation; Kelly Wolfe, Rich Feeley, and Alvaro J. Monroy at CMS; John Holley, an independent consultant; Clint Stinger and Margaret Dijkerman at Deloitte Touche Tohmatsu Emerging Markets; and Anis Jabsheh at Deloitte Touche Tohmatsu Middle East. Also, thanks to the many people at USAID who provided us with their insight.

ABSTRACT

The Commercial Market Strategies project prepared *Funding for the Future? Lessons From the Past: A Review of USAID Dollar-Appropriated Endowments* in response to a request by USAID's Bureau of Policy and Program Coordination (PPC) and Bureau of Global Health, Office of Population and Reproductive Health (G/PRH), for a comprehensive review of dollar-appropriated endowments and the guidelines used to manage them. An endowment is a sum of money that is gifted by a donor to a recipient, set aside for a specific purpose, and invested to generate a stream of income. Endowments may be set up for a specific term or designed to exist in perpetuity. Many donors, including USAID, have used endowments as a tool for sustainable development. Through the early

1990s, USAID could only fund endowments with local currency, which did not provide reliable earnings because of local currency devaluations. In 1994, new legislation and the development of *Policy Directive 21, Guidelines: Endowments Financed With Appropriated Funds (PD-21)*, opened the door for USAID Bureaus and Missions to establish and fund endowments with dollar appropriations. This publication reviews more than 25 USAID endowments funded since PD-21, across diverse sectors and geographic regions. The endowments reviewed ranged in size from less than \$1 million to close to \$200 million and were designed for different purposes, among them, to initiate or sustain a specific development project, to sustain an organization, to develop a sector through a grant program, and to leverage funds from new donors. The report documents the experiences, lessons learned, and best practices gleaned from these endowments. It also analyzes PD-21 in light of these experiences and outlines recommendations for future endowments.

KEY WORDS

Endowment, sustainability, investment(s), NGO, health, environment, historic preservation, education, community development/social mobilization, Africa, Latin America, Asia, Europe, Eurasia, PD-21, USAID, PPC, dollar denominated, dollar appropriated.

RECOMMENDED CITATION

Javaid, A; D Escueta; and R Bonardi. 2003. *Funding for the Future? Lessons From the Past: A Review of USAID Dollar-Appropriated Endowments*. Washington, DC: USAID/Commercial Market Strategies Project.

COVER PHOTO

Boy in Bangladesh, where about 20 percent of deaths of children under five are associated with diarrhoea. In 1996, in an effort to reduce such deaths, USAID provided a \$1 million endowment to the International Center for Diarrhoeal Disease Research in Bangladesh. Photo by Paul Bankerd/CCP, courtesy of Photoshare, a service of USAID's INFO project.

Funding for the Future? Lessons From the Past: A Review of USAID Dollar-Appropriated Endowments

OCCASIONAL PAPER SERIES
February 2002

CONTENTS

	Abbreviations and Acronyms	v
	Executive Summary	1
1	Introduction	5
	<i>Overview</i>	7
	<i>The Review</i>	8
	<i>The Report</i>	10
2	Findings	11
	<i>The Endowment Process</i>	13
	<i>Endowments Reviewed</i>	13
	<i>Development/Endowment Objectives</i>	14
	<i>Structure of the Endowments</i>	18
	<i>Category One: The Recipient Organization and Endowment Preparation</i>	18
	<i>Category Two: Endowment Funds</i>	22
	<i>Category Three: USAID and Its Role</i>	27
3	Lessons Learned	31
	<i>Category One: The Recipient Organization</i>	33
	<i>Category Two: Endowment Funds</i>	34
	<i>Category Three: USAID and Its Role</i>	37
	<i>USAID and Endowments</i>	39
	<i>Use of Endowments</i>	40

4	Recommendations	41
	<i>Category One: The Recipient Organization and Endowment Preparation.....</i>	<i>43</i>
	<i>Category Two: Endowment Funds.....</i>	<i>45</i>
	<i>Category Three: USAID and Its Role.....</i>	<i>47</i>

APPENDICES

A	Scope of Work for a Review of USAID's Endowments Funded With Appropriated Dollars....	53
B	Endowment Assessment	59
C	Endowments Considered for Inclusion in the Review.....	65
D	PD-21 Compliance Questionnaire.....	69
E	Endowment Size/Cost Worksheet	73

FIGURE

1	The endowment process	13
----------	-----------------------------	----

TABLES

1	Overview of analyzed endowments.....	15
2	Brief description of analyzed endowments	16
3	History of endowment recipients.....	20
4	Internal financial management.....	22
5	Intermediate results and uses of funds	24
C1	List of all endowments considered	67
D1	Questionnaire	71

ABBREVIATIONS and ACRONYMS

ABF	Amy Biehl Foundation — South Africa
ACCORD	African Center for Constructive Resolution of Disputes — South Africa
ACOR	American Center for Oriental Research — Jordan
APROFE	Asociación Pro Bienestar de la Familia Ecuatoriana — Ecuador
ARIAS	Arias Foundation for Peace and Human Progress — Costa Rica
AUA	American University of Armenia — Armenia
AUBG	American University of Bulgaria
BAPF	Baltic–American Partnership Fund
CADERH	Centro Asesor para el Desarrollo de los Recursos Humanos/Advisory Council for Human Resources — Honduras
CARE	Cooperative for Assistance and Relief Everywhere — Reproductive Health Trust Fund
CEMOPLAF	Centro Médico de Orientación y Planificación Familiar — Ecuador
CD	Certificate of deposit
CP	Condition precedent
FIDECO	Ecological Trust Fund for Fundación Natura — Panama
FMCN	Mexico Fund for the Conservation of Nature
GC	Office of the General Counsel
GEF	Global Environment Facility
GHCT	Ghana Heritage Conservation Trust
GSMF	Ghana Social Marketing Foundation — Ghana
ICDDR/B	International Center for Diarrhoeal Disease Research — Bangladesh
IPPF/EFS	International Planned Parenthood Federation/Western Hemispheric Region — Endowment Fund for Sustainability
KEHATI	Indonesia Biodiversity Foundation — Indonesia
KIASIA	Kenan Institute Asia — Thailand

LEG	Legislative and legal advisor
LIFTS	Endowment Fund for Local Initiatives for Tolerance and Sustainability — South Eastern Europe
MACF	Millennium Armenian Children’s Fund/Ani and Narod Memorial Fund
NGO	Non-governmental organization
OP	Office of Procurement
PAFF	Polish American Freedom Foundation
PD-21	<i>Policy Directive 21, Guidelines: Endowments Financed With Appropriated Dollars</i>
PPC	Office of Policy and Program Coordination
PROFAMILIA	Fund for Family Planning in Latin America — Colombia
PROSALUD	Asociación Protección a la Salud — Bolivia
PVO	Private voluntary organization
RBT	Ron Brown Trust — South Africa
REIT	Real estate investment trust
RFP	Request for proposal
RLA	Regional legal advisor
SBGT	Swazi Business Growth Trust — Swaziland
TI-GC	Transparency International–Global Corruption
USAID	United States Agency for International Development
USAID/W	USAID/Washington

Executive Summary

EXECUTIVE SUMMARY

An endowment, at times called a trust or sustainability fund, is a sum of money set aside for a specific purpose and invested to generate a stream of income. The funds to establish an endowment usually are granted as a gift from one organization or entity (such as a philanthropist or a donor) to another organization (for example, a university, a non-profit organization, or social service organization). Typically, the endowment money (called the principal or corpus) must remain invested, and only the income generated from the principal is used to finance programs or operations.

Endowments may be established with a specific term (sinking or wasting), or they may be designed to exist in perpetuity (evergreen or perpetuity). A sinking endowment is one that allows the recipient to draw down on the principal over time, thereby reducing the amount of the endowment and eventually eliminating it. An evergreen endowment lasts in perpetuity and allows for long-term planning or stability.

Since the 1970s, the United States Agency for International Development (USAID) has been looking for mechanisms under which it could provide long-term support for institutions and activities overseas. This was especially pertinent in programs whose priorities were changing or in nations where USAID was limiting or terminating its activities. Prior to 1990, options were limited, as restrictions existed on non-governmental organizations (NGOs) earning and retaining interest on local currency acquired through the exchange of appropriated dollars. As such, USAID's long-term funding mechanisms were local-currency denominated. The Foreign Assistance Appropriations Act of 1990 took the first step to change this requirement, allowing NGOs to retain interest on and establish endowments with local currency acquired through the exchange of appropriated dollars. In 1993, Congress allowed NGOs to retain interest on appropriated dollars retained as dollars, as well as those held as local currency. It also allowed NGOs to establish endowments with these funds. Reinforced in 1994, the legislation permitted NGOs to establish endowments with funds directly granted by USAID without the requirement of local-currency conversion.

To help USAID Missions and potential recipient organizations understand the legislative changes and implement endowments, *Policy Determination 21, Guidelines: Endowments Financed With Appropriated Funds (PD-21)* was issued in July 1994. This document delineated the major aspects of the endowment process and structure and offered general parameters regarding the roles and responsibilities of those involved in it.

Eight years have passed since the issuance of *PD-21*, and almost 30 USAID-funded endowments have been implemented under the guidelines. The recipients are from all regions and a variety of sectors, including health, environment, civil society, and historic preservation. The majority of the endowments are evergreen, although there are 6 sinking funds among them. The sizes of the funds range from \$400,000 to almost \$200 million. Most endowments are considered useful and successful; only 2 have been terminated.

Given the passage of time and the varied experiences of those endowments that have been implemented under *PD-21*, USAID sought to document the lessons learned and assess the effectiveness of the guidelines. This study is a comprehensive review of USAID dollar-appropriated endowments, focusing on the managerial and financial structures of the endowment mechanism. It analyzes the specific experiences of 23 dollar-appropriated endowments and examines how USAID Missions and recipients have worked with the policy guidelines used to design and manage them. The objective of the review is to document the lessons learned from these endowments and to propose recommendations for future USAID policy guidelines.

For this review, 205 individuals from USAID/Washington and 16 USAID Missions were contacted. In-depth interviews were conducted with 65 representatives of USAID and recipient organizations using a structured questionnaire (see Table D1). Site visits were conducted with eight endowments to examine specific issues, such as governance, endowment structures, asset management, and USAID monitoring and evaluation approaches. The team then analyzed the structure of endowments and the operational experiences in management, finance, investing, and oversight.

The research revealed a wide array of profiles, experiences, successes, and challenges with regard to how endowments were designed, implemented, and monitored. Investment portfolios were equally varied, including those with medium risk and a majority percentage in equity instruments as well as those with minimal risk held in cash or bonds. Additionally, the roles and responsibilities of USAID in terms of oversight depended on the individuals assigned to manage the endowment and the history of the recipient organization itself.

The review did not include analysis of the social impact of the endowments, such as number of children saved or forests protected, as this information was difficult to obtain and compare. Additionally, recipient organizations did not measure usefulness or effectiveness of the endowment in this way. However, the review addressed, in certain cases, whether the recipient organizations had achieved specific organizational or programmatic goals (milestones or intermediate “process” indicators) as a result of the endowment.

Though *PD-21* provided a mechanism to standardize the endowment structure and process within USAID, there were still challenges. The most common challenges included difficulties fulfilling the conditions precedent (CPs) and obtaining tax-exempt status in the United States. Additional questions arose in the areas of investing, oversight, and spending patterns. Most recipient organizations were international NGOs unfamiliar with non-profit and tax laws of the United States or with USAID regulations. Additionally, though *PD-21* offered guidance in a number of areas, from endowment objectives to profiles of the NGO and the role of USAID, the guidance was at times interpreted differently.

Based on these findings, USAID should consider the recommendations to improve its ability to design and monitor endowments. Some include specific changes in the current policy guidelines, as well as mechanisms for USAID personnel to become more familiar with *PD-21*, using it not only to assist in projects or sectors, but also to forge new partnerships and leverage funds. Here are a few examples:

- a more rigorous screening process for potential recipient organizations is needed to ensure that those who receive an endowment can manage and implement it properly

- recipient organizations should be better prepared to receive and manage the endowment; holding them accountable in terms of reporting and spending is vital
- USAID and recipient organizations must have a better understanding of the costs to establish and maintain an endowment and be able to calculate the appropriate size of one (worksheets were designed to assist in this regard)
- USAID must monitor the endowments better to ensure compliance with the grant agreement, the CPs, and the reporting requirements

Overall, the endowment mechanism is seen as useful, but better information sharing must be implemented. Knowledge about endowments and *PD-21* exists throughout USAID, but it is not being properly or fully utilized. Tapping into this knowledge requires a new system of sharing information and employing experts (within USAID and via outside consultants) to guide the process, thereby preventing potential problems and minimizing liabilities.

The study concluded that endowments are a powerful tool, allowing an organization to build and plan for the future — either in a specific activity or a sector. The experiences of the endowments reviewed yield valuable lessons, not only for other endowments, but also for USAID. Analyzing these lessons and implementing the recommendations will allow USAID to revamp its policy guidelines and ensure that endowments remain a viable funding mechanism.

1 Introduction

INTRODUCTION

OVERVIEW

ENDOWMENTS — DEFINITION AND TYPES

An endowment, at times called a trust or a sustainability fund, is a sum of money or fund set aside for a specific purpose and invested to generate a stream of income. The funds to establish an endowment are usually granted as a gift from one organization or entity (such as a philanthropist or donor) to another organization (such as a university, non-profit organization, or social service organization). Typically, the endowment money (called the principal or corpus) must remain invested, and only the income generated from the principal is used. The uses of endowment funds vary, according to the wishes of the donor organization, and can include the following:

- supporting operational expenses
- funding new activities
- promoting partnerships and initiatives within a given sector

Endowments may be set up with a specific term (a sinking, or wasting, endowment), or they may be designed to exist in perpetuity (an evergreen, or perpetuity, endowment).

A sinking endowment is one that allows the grantee to draw down on the principal over a period of time, thereby reducing the amount of the endowment and eventually eliminating it.

An evergreen endowment lasts in perpetuity and allows for long-term planning or stability. This type is most effective when the total endowment amount is large, allowing for sufficient income generation to cover program or operating expenses without invading the principal.

ENDOWMENTS AND USAID

Since the 1970s, the United States Agency for International Development (USAID) sought mechanisms under which it could provide long-term support for institutions and activities overseas. This was especially pertinent in programs whose priorities were changing or in nations where USAID was limiting or terminating its activities.

Prior to 1990, options were limited, as restrictions existed on non-governmental organizations (NGOs) earning and retaining interest on local currency acquired through the exchange of appropriated dollars. As such, USAID's long-term funding mechanisms were local-currency denominated. A popular program at that time was the PL-480 program that generated local income through the sale of donated food. Within this program, USAID Missions were able to use the income generated, in partnership with local organizations, to establish agricultural research institutions and similar entities. Initiatives such as the Agricultural College of the Humid Tropical Region in Costa Rica, the Agricultural Research Fund in Honduras, and the Superior Institute of Agriculture in the Dominican Republic are examples of long-term funding mechanisms built via income earned through the PL-480 program.

Another source of funds for long-term local-currency initiatives were debt-for-nature swaps. In this arrangement, USAID provided funds to an NGO to purchase national debt, which was then redeemed by the host government with local funds. The result included a wide variety of new environmental initiatives, such as the Foundation for the Philippine Environment and the Enterprise Initiative of the Americas Funds in Argentina, Bolivia, and Chile.

In 1990, the Foreign Assistance Appropriations Act took the first step to permit endowments to be used as a long-term funding mechanism. It allowed NGOs to retain interest on endowments and to establish them with local currency acquired through the exchange of appropriated dollars. Additional changes came in 1993, when Congress allowed NGOs that were contractors of USAID to retain the interest earned on appropriated dollars, as well as those held as local currency. It also allowed NGOs to establish endowments with these funds. This provision was re-enacted in 1994, thus allowing NGOs to establish endowments with funds directly granted by USAID without the requirement of local currency conversion.

Following these legislative changes, endowments became a more acceptable and available mechanism within USAID to ensure long-term funding and support for an initiative or organization. Originally, local-currency endowments were popular, though local-currency devaluation posed a major risk, thus limiting the ability of an organization to consider the endowment a reliable source of earnings. For example, a USAID grant to the Agricultural Development Foundation in the Dominican Republic (1987) lost about half of its original dollar-appropriated value, leaving it with only \$2.7 million by 1993.

The 1994 legislation opened the door for endowments funded with dollars to remain as dollars. However, no guidelines existed to assist Missions, USAID officials, or recipient organizations establish or implement a dollar-appropriated endowment. Therefore, a policy directive or other set of legislative guidelines was required.

THE EVOLUTION OF *PD-21*

To clarify the parameters of endowments as a long-term funding mechanism and specifically to outline the implications related to dollar denomination, USAID issued *Policy Determination 21, Guidelines: Endowments Financed With Appropriated Funds*, or *PD-21*, in July 1994. This document, issued to assist Missions and potential recipient organizations (mostly NGOs), outlined a number of critical areas regarding dollar-appropriated and denominated endowments, including scope and authority, design and approval, obligation, monitoring and oversight, and joint efforts (such as multi-donor endowments). Though not law, *PD-21* was meant to establish standards under which dollar-appropriated endowments would be established, maintained, and monitored.

PD-21 delineated the major aspects of establishing an endowment and outlined some of the options for recipient organizations. For example, it discussed potential goals for an endowment, highlighting the need for a clear plan for use of funds, and noted the complexities of tax regulations and liability. This determination was meant to ensure that there was a standard process that all endowments would follow.

The guidelines were not meant to be prescriptive; they did not dictate terms, such as the required age of the organization, the type of leadership, or even the specific portfolio in which funds must be invested. However, *PD-21* did implement an approval process in Washington for all endowments established under these guidelines and offered references to additional sources of information.

THE REVIEW

OBJECTIVES

In recent years, USAID has been eager to document and analyze the experiences of NGOs endowed with appropriated dollars and the *PD-21* guidelines. This is partly because, as donor dollars decrease, endowments are becoming a more popular and longer-term mechanism for USAID Missions to fund organizations and institutions. However, a wide variety of questions have emerged about USAID's experience with this mechanism:

- What types of organizations receive endowments from USAID?
- How are the endowment funds, either income or principal, used?
- How is the endowment managed?
- What is the financial performance of the endowment?
- How does USAID oversee the endowment?
- Has *PD-21* been an effective document in establishing appropriate parameters for dollar-appropriated endowments?

In an attempt to answer these questions and analyze the prospects for this funding mechanism, USAID requested a review of all dollar-appropriated endowments and *PD-21* to document the experience of dollar-appropriated endowments and analyze *PD-21*, in light of these experiences.

The scope of work for this review (see Appendix A) included a number of key points to research in the areas of oversight, operations, portfolio management, and policy issues. As a result, the review analyzes these points, as well as several critical aspects of management and operations, such as the effectiveness of the endowed organization to meet its objectives, the management of the portfolio and disbursement of funds, the ability of USAID and other entities to monitor the recipient organization, and lessons learned for future endowments.

Documenting the experience of dollar-appropriated endowments will allow USAID to understand best practices, lessons learned, and challenges of the individual endowments and determine whether *PD-21* was effective, adhered to, or an obstacle.

APPROACH AND METHODOLOGY

In June 2001, the team began desktop research and preliminary meetings with Bureau representatives to understand, on a macro level, the opinions of and experiences with endowments and the utilization of and/or challenges with *PD-21*. We reviewed studies issued by USAID and other donors, such as the Global Environment Facility (GEF) of the United Nations Development Programme (UNDP) and the World Bank. We also analyzed reports from private funders (specifically, the Ford Foundation) that have issued specific guidelines for both those who fund and those who receive endowments. This research was done to understand conclusions and compare lessons learned with the results of our analysis.

Following this overview of major issues, our team spent several months contacting individuals and obtaining documents. In this process, we contacted 205 people in USAID/Washington (USAID/W) and 16 USAID Missions (Armenia, Bangladesh, Bolivia, Ecuador, Ghana, Honduras, Indonesia, Jordan, Mexico, Panama, Peru, Philippines, South Africa, Swaziland, Gaza/West Bank, and Zimbabwe), conducted 65 in-depth interviews, and had site visits in eight cases (Bolivia, Mexico, Panama, Indonesia, Jordan, Ghana twice, and South Africa).

Two or three endowments from each region or USAID Bureau were selected for in-depth study. They included the following:

- Asociación Protección a la Salud (PROSALUD; Bolivia), Mexico Fund for the Conservation of Nature (FMCN; Mexico), and Ecological Trust Fund for Fundación Natura (FIDECO; Panama) from the Latin American Bureau
- the American University of Bulgaria (AUBG) and the Baltic–American Partnership Fund (BAPF) from the Europe and Eurasia Bureau
- African Center for Constructive Resolution of Disputes (ACCORD; South Africa), Ghana Social Marketing Foundation (GSMF; Ghana), and Ghana Heritage Conservation Trust (GHCT; Ghana) from the Africa Bureau
- Indonesia Biodiversity Foundation (KEHATI; Indonesia), International Center for Diarrhoeal Disease Research (ICDDR/B; Bangladesh), and American Center for Oriental Research (ACOR; Jordan) from the Asia/Near East Bureau
- Fund for Family Planning in Latin America (PROFAMILIA; Colombia) and International Planned Parenthood Federation/Western Hemispheric Region — Endowment Fund for Sustainability (IPPF/EFS) from the Global Bureau

Our team worked with Bureau representatives to select endowments in various nations and of varied sectors, ages, sizes, and histories to compare operational experiences both within and beyond a given Bureau. The majority of those selected for in-depth analysis included a site visit — USAID and the recipient organization were contacted in these instances.

Designated USAID Bureau representatives concurred on which endowments would be visited. Those selected represent a good cross-section. The AUBG and BAPF were selected as candidates for site visits, but the specific circumstances of these endowments prevented the visits: AUBG is in the process of negotiating a new endowment, and BAPF operates in a delicate balance of power between USAID and Soros that is carefully guarded. In these two instances, in-depth interviews with key USAID officials and careful review of pertinent documents were undertaken to understand their specific experiences.

In addition to the endowments selected for in-depth analysis, an additional 10 endowments were reviewed, including American University of Armenia (AUA; Armenia), Millennium Armenian Children's Fund/Ani and Narod Memorial Fund (MACF; Armenia), Arias Foundation for Peace and Human Progress (ARIAS; Costa Rica), Centro Médico de Orientación y Planificación Familiar (CEMOPLAF; Ecuador), Asociación Pro Bienestar de la Familia Ecuatoriana (APROFE; Ecuador), Cooperative for Assistance and Relief Everywhere — Reproductive Health Trust Fund (CARE), Centro Asesor para el Desarrollo de los Recursos Humanos/Advisory Council for Human Resources — Honduras (CADERH; Honduras), Polish American Freedom Foundation (PAFF), Swazi Business Growth Trust (SBGT; Swaziland), and Kenan Institute Asia (KIASIA; Thailand). For these endowments, documents were gathered and interviews undertaken, though not to the same level of detail as those specifically chosen by regional Bureau representatives. This is because some of these endowments are quite small, and others are beyond the oversight period. USAID officials, therefore, preferred that our attention be directed to active endowments whose management or operations can be improved.

It is important to note that the two Ecuador endowments — CEMOPLAF and APROFE — were included, even though they are not considered endowments by Mission staff. Staff indicated that these are sustainability funds, funded through the sale of local supplies, the costs of which are subsidized by USAID. However, our review of the documents, including the cooperative agreement, seems to indicate that a large percentage of all funds disbursed by USAID are to be placed directly into the sustainability fund. Given this arrangement, our team felt that these sustainability funds operate largely like endowments and therefore should be analyzed as part of this review.

To ensure consistency in information gathering, the team designed and utilized an assessment tool (Appendix B) covering all major aspects of the endowment experience, such as the recipient organization and its history; the assets, including management and performance; the key players; and the role of USAID.

THE REPORT

This report is divided into four broad sections: Introduction, Findings, Lessons Learned, and Recommendations. The Introduction outlines endowments in general and the review process and sets the stage for the presentation of results. Each of the final three sections deals with common themes or subsections, such as the recipient, the funds and their investment, and USAID's role.

- Findings addresses and documents the factual situations/experiences of the endowments under review to get a sense of what has taken place, based on the three major structural aspects: the recipient, the funds, and USAID.
- Lessons Learned synthesizes the experiences into specific best practices or approaches to be avoided when structuring and managing endowments, both for USAID and the recipient organizations. Lessons Learned is based on the findings, but is subject to interpretation and analysis.
- Recommendations offers specific ideas and steps related to *PD-21* and the actual management/oversight of endowments, some of which may not be fully covered under *PD-21*.

2 Findings

FINDINGS

THE ENDOWMENT PROCESS

Before delving into the specific experiences of the endowments funded by USAID under *PD-21*, it is important to understand the process of implementing an endowment: the steps from the earliest discussions to the signing of the grant agreement. The following flowchart (see Figure 1) depicts the major steps in the process and notes the points at which revisions, submissions, and approvals occur.

PD-21 does not discuss the pre-approval or planning stages of the process and says very little about the approvals themselves. It only specifically mentions that approval from both the Office of Policy and Program Coordination (PPC) and the Office of the General Counsel (GC) at USAID/W is required prior to Bureau approval.

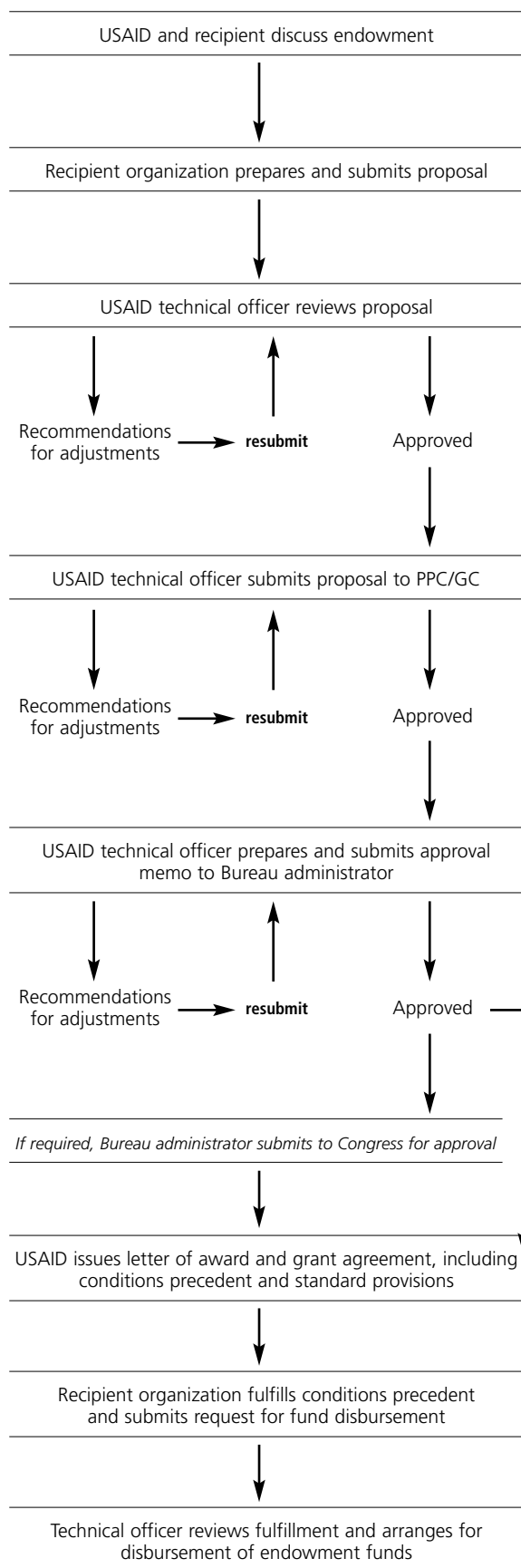
The guidelines also say little about the timeline for the entire process, mentioning only how long it should take to obtain tax exemption. Individual circumstances can vary the length of time needed to design, formalize, and fund an endowment. *PD-21*, however, does not outline an average process or parameters affecting the length of the process. In some cases, the entire process took 9 to 10 months, and in other instances, the process lagged for two to three years. The specific circumstances of the endowments, discussed below, will outline some of the key factors in the process that affect the timeline for implementation.

ENDOWMENTS REVIEWED

Recipients of USAID dollar-appropriated endowments are varied, covering all regions and sectors. We considered 43 endowments for inclusion in this review (see Appendix C, Table C1).

Some of those originally considered were excluded for reasons of funding source (i.e., local currency or because USAID chose not to approve the endowment proposal). There were also several for which we could only verify existence, but not uncover additional information, such as the funding source (dollar or local currency) or key documentation. They included endowments in Madagascar (four), the Ivory Coast,

Figure 1. The endowment process



Bhutan, Nepal, and Central/Eastern Europe. In other instances, endowments were funded locally, by sources other than USAID, are stopped, or on hold.

As such, the list was narrowed to 23 endowments with an additional 5 reviewed in brief, but not analyzed as they were too new (in some cases still in the design phase) for full inclusion or comparison. Table 1 provides an overview of the 23 current endowments and the 5 new endowments reviewed in this report, along with some basic information regarding the region, size, and type of these endowments. Table 2 provides a brief description of each of the 23 endowments analyzed.

A review of Table 1 indicates that endowments are spread across all regions and Bureaus, with seven in Latin America, five in Europe and Eurasia, four each in Africa and Asia, and three in the Global Bureau (including two with Latin American emphasis, PROFAMILIA and IPPF/EFS, and one with a global mandate, CARE).

The endowments also vary by sector, though health is the most popular, with nine. Three are considered to be educational endowments, though only two are for schools — the AUA and the AUBG — and one is for technical and vocational training, CADERH. Additionally, there are four endowments in the area of civil society and five related to the environment. Two endowments do not clearly fit into these categories and are noted separately: SBTG for private-sector growth and ACOR for historic preservation.

In dollar terms, the endowments also vary tremendously. For example, the MACF is \$400,000 and CADERH is \$600,000. The largest endowment, PAFF, has yet to reach its full size of potentially close to \$200 million.¹

Last, most endowments are relatively new, as *PD-21* was implemented in 1994. Of those analyzed, only two (ARIAS and PROFAMILIA — Colombia) pre-date *PD-21*. Most were conceived in the mid-1990s, though it took a few years to finalize the details of the proposals and sign the agreements.

Most groups have only received one endowment thus far from USAID. However, AUBG is negotiating for a second endowment following the early termination of their first one. Also, ACOR has received three endowments (1997, 1999, and 2001) to further specific initiatives.

DEVELOPMENT/ENDOWMENT OBJECTIVES

Though the purpose of this report is neither to study the development objectives nor to quantify/evaluate the impact of the endowment for an organization or in a given society, a brief discussion of general development objectives is warranted.

Most endowments are established with an articulated development objective in mind, such as an improved environment (e.g., better air quality, more protected forests, or cleaner water) or healthier people (e.g., increased couple years of protection, CYPs; safe delivery; or increased immunization rates). These goals, however, though broadly outlined in the endowment proposals and usually based on the strategic objectives of a given Mission or Bureau, were often not quantified. In fact, only the GSMF endowment proposal and cooperative agreement outlined sector-specific development indicators that had to be met prior to disbursement of funds. The remainder of the endowments analyzed did not use development objectives either to regulate disbursement of funds or to measure the success of the endowment. This may be because studies indicate that the development impact of an endowment is often minimal and, if evident, is often manifested many years after the original disbursement.²

Most endowment proposals, therefore, discuss the broad development objectives, but narrow the focus or goal of the endowment to an intermediate objective, such as sustainability or sector renewal. For example, none of the endowments analyzed tried to solve the reproductive health challenges of a given country. However, endowments were undertaken to improve the chances of survival of an organization that works in reproductive health.

1 Funds for this endowment are the proceeds from asset sales under the Polish Enterprise Fund. This is a special case, as it is a non-traditional source of endowment funds and not one originally envisioned under *PD-21*. Nonetheless, it is considered an endowment, and the *PD-21* guidelines were followed in its establishment.

2 Horkan, KM and PL Jordan. July 1996. *Endowments as a Tool for Sustainable Development*. USAID/Center for Development and Evaluation.

Table 1. Overview of analyzed endowments

Country/ region	Name of endowment/grantee	Sector	Amount of USAID endowment fund (\$ millions)	Date of contract/ agreement	Type of fund
Armenia	American University of Armenia (AUA)	Education	9.6	1999	Evergreen
Armenia	Millennium Armenian Children's Fund (MACF)/ Ani and Narod Memorial Fund	Health	0.400	2001	Sinking (5 years)
Baltics	Baltic–American Partnership Fund (BAPF)	Civil society	7.5	1998	Sinking (10 years)
Bangladesh	International Center for Diarrhoeal Disease Research (ICDDR/B)	Health	1	1996	Evergreen
Bolivia	Asociación Protección a la Salud (PROSALUD)	Health	5	1997	Evergreen
Bulgaria	American University of Bulgaria (AUBG)	Education	14.8	1997	Sinking (10 years)
Colombia	Fund for Family Planning in Latin America (PROFAMILIA)	Health	6	1993	Evergreen
Costa Rica	Arias Foundation for Peace and Human Progress (ARIAS)	Civil society	0.500	1993	Evergreen
Ecuador	Centro Médico de Orientación y Planificación Familiar (CEMOPLAF)	Health	7.7	1997	Evergreen
Ecuador	Asociación Pro Bienestar de la Familia Ecuatoriana (APROFE)	Health	5.15	1998	Evergreen
Ghana	Ghana Social Marketing Foundation (GSMF)	Health	5	1997	Sinking (20 years)
Ghana	Ghana Heritage Conservation Trust (GHCT)	Environment	2	1998	Evergreen
Global	CARE — Reproductive Health Trust Fund (CARE)	Health	9	1999	Sinking (15 years)
Global	International Planned Parenthood Federation/ Western Hemispheric Region — Endowment Fund for Sustainability (IPPF/EFS)	Health	4	1997	Evergreen
Honduras	Centro Asesor para el Desarrollo de los Recursos Humanos/Advisory Council for Human Resources (CADERH)	Education	0.600	1995	Sinking (20 years)
Indonesia	Indonesia Biodiversity Foundation (KEHATI)	Environment	16.5	1995	Evergreen
Jordan	American Center for Oriental Research (ACOR)	Historic preservation	0.900 0.185 2	1997 1999 2001	Evergreen
Mexico	Mexico Fund for the Conservation of Nature (FMCN)	Environment	19.5	1997	Evergreen
Panama	Ecological Trust Fund for Fundación Natura (FIDECO)	Environment	8	1995	Evergreen
Poland	Polish American Freedom Foundation (PAFF)	Civil society	80 to 200	1999	Evergreen
South Africa	African Center for Constructive Resolution of Disputes (ACCORD)	Civil society	5	1998	Evergreen
Swaziland	Swazi Business Growth Trust (SBGT)	Private-sect. growth	5	1995	Evergreen
Thailand	Kenan Institute Asia (KIASIA)	Environment	3.5	1996	Evergreen
South Africa	Amy Biehl Foundation (ABF)	Civil society	At design stage		
South Africa	Ron Brown Trust (RBT)	Private-sect. growth	Approved, in implementation		
South Eastern Europe	Endowment Fund for Local Initiatives for Tolerance and Sustainability (LIFTS)	Civil society	RFP issued for recipient organization		
Global	Transparency Int'l—Global Corruption (TI—GC)	Civil society	At proposal stage		
Gaza/West Bank	Education	Education	At design stage		

Table 2. Brief description of analyzed endowments**Armenia**

American University of Armenia (AUA) was established in 1991 to provide American-style higher education in Armenia. The evergreen endowment was established in 1999 with \$9.6 million from USAID to provide financial stability and predictability for the future of the university.

Millennium Armenian Children's Fund (MACF) was established in 2001 for the purpose of creating a sustainable supply of childhood vaccines in Armenia. The fund was established in partnership with The Ani and Narod Memorial Fund, a private non-profit organization that aims to assist Armenian women and children through health and education. The 5-year sinking fund includes \$400,000 from USAID.

Baltics

Baltic–American Partnership Fund (BAPF) is a 10-year sinking fund that was established in 1998 to serve as a grant-making mechanism for NGOs in Estonia, Latvia, and Lithuania. The fund supports initiatives that strengthen NGO capacity; promote private philanthropy, tax, and legal reforms; and provide interim grant assistance. The fund was endowed with \$7.5 million from USAID. Soros representatives in each of the three countries mentioned are the implementing partners or subgrantees and, in turn, provide subgrants to local NGOs. Soros also matches the fund with a dollar for every dollar drawn down from the capital fund provided by USAID.

Bangladesh

International Center for Diarrhoeal Disease Research — Bangladesh (ICDDR/B) is an international non-profit institution devoted to developing and disseminating solutions to major health and population problems. The center was originally established in 1960 by the United States and Pakistan as the Cholera Research Laboratory and transformed into an independent organization (ICDDR/B) in 1978. In 1996, USAID's Office of Population, Health, and Nutrition provided \$1 million to co-fund an evergreen endowment that serves as a long-term funding source for research activities in child survival.

Bolivia

Asociación Protección a la Salud (PROSALUD) is an independent organization that provides health care services to the middle- to low- and lower-income segments of the population in Bolivia. PROSALUD began with initial funding from USAID in 1985. In 1997, USAID established a \$5 million evergreen endowment for PROSALUD to help the organization expand its services and promote its long-term sustainability.

Bulgaria

American University of Bulgaria (AUBG) is a non-governmental non-profit educational institution formed in 1991 with substantial USAID support and financial assistance; it was incorporated in Maine and chartered in Bulgaria. In 1997, USAID established a \$15 million 10-year sinking fund for the long-term financial sustainability of AUBG. This fund was spent down faster than anticipated. Consequently, the endowment was recapitalized and a second endowment, this time an evergreen endowment, is in the final stages of planning and development.

Colombia

Fund for Family Planning in Latin America was established in 1993 to benefit **PROFAMILIA**. PROFAMILIA was founded in 1965 and is the largest provider of family planning services in Colombia. The evergreen fund was endowed with \$6 million from USAID to serve as a long-term financial cushion that would allow PROFAMILIA to support and provide critical services it would otherwise be unable to provide, given the need to become fully sustainable.

Costa Rica

Arias Foundation for Peace and Human Progress (ARIAS) in Costa Rica, established in 1988, was provided with \$500,000 by USAID in 1993 for the purpose of supporting the foundation's efforts to maintain and reinforce their overall endowment fund.

Ecuador

Centro Médico de Orientación y Planificación Familiar (CEMOPLAF), a family planning NGO in Ecuador established in 1974, was endowed with \$7.7 million* from USAID in 1997 for the purpose of helping to ensure the organization's sustainability.

Asociación Pro Bienestar de la Familia Ecuatoriana (APROFE), a family planning NGO in Ecuador established in 1965, was endowed with \$5.15 million in 1998 for the purpose of ensuring the organization's sustainability.

Ghana

Ghana Social Marketing Foundation (GSMF) is a non-profit organization established in 1993 with assistance from USAID for the purpose of implementing family planning and contraceptive social marketing programs in Ghana. A \$5 million sinking fund was established in 1997 to help ensure the organization's financial sustainability.

Ghana Heritage Conservation Trust (GHCT) was established in 1996 through the merger of two separate trusts: the Castles and Fort Trust and the Kakum National Park Trust. In 1998, USAID endowed GHCT with \$2 million for an evergreen fund to promote the preservation and conservation of globally important biodiversity and historic monuments located in Ghana's central region.

* Anecdotal information reveals that the actual amount may be closer to \$3.4 million, with certain funds misappropriated following misuse.

Table 2. Brief description of analyzed endowments (continued)

Global

Reproductive Health Trust Fund was established in 1999 to benefit the **Cooperative for Assistance and Relief Everywhere (CARE)**, a US-based private voluntary organization that has been in existence since 1945. The 15-year sinking fund was endowed with \$9 million from USAID for the purpose of helping CARE continue its reproductive health work by providing long-term financial sustainability.

Endowment Fund for Sustainability was established in 1997 to benefit the **International Planned Parenthood Federation/Western Hemispheric Region (IPPF/EFS)**. IPPF/WHR, founded in 1954, is a network of family planning NGOs throughout the LAC region affiliated through common goals and funding. The \$4 million evergreen endowment serves as a permanent source of financing to support the organization's sustainability within the region.

Honduras

Advisory Council for Human Resources (CADERH), a non-profit, private training institution formed in 1982 to provide technical assistance, quality control, and personnel training to NGOs and municipal non-formal vocational training (NVT) centers in Honduras was endowed with \$600,000 by USAID. The 20-year sinking fund was established in 1995 for the purpose of assisting the long-term sustainability of the institution.

Indonesia

USAID and key Indonesian leaders formed the **Indonesia Biodiversity Project (KEHATI)** in 1994 as the nation's first independent, self-sustaining biodiversity institution. To fulfill the organization's mandate, USAID endowed KEHATI with a \$16.5 million evergreen fund in 1995 to provide a sustainable source of funding for the foundation's catalytic grant-making programs to conserve Indonesia's biological diversity.

Jordan

American Center of Oriental Research (ACOR) was established in 1968 as an independent organization to further archaeological and conservation activities in Jordan. In 1997, 1999, and 2001, USAID endowed ACOR with three separate evergreen endowments, totaling \$3.08 million, to establish a financially viable and self-sustaining institution for archaeological and conservation activities, primarily in Petra.

Mexico

Mexico Fund for the Conservation of Nature (FMCN) was formally established as an organization in 1994 for the explicit purpose of managing the environmental fund created by USAID and the government of Mexico. USAID provided \$19.5 million to the evergreen fund, which has since received additional contributions from various donors.

Panama

Ecological Trust Fund for Fundación Natura or Fidecomiso Ecologico de Panama (**FIDECO**) was established in 1995 for the purpose of conserving the renewable natural resources of and promoting environmental protection activities in Panama. To implement the program, The Nature Conservancy (TNC) helped create a local environmental NGO called the Fundación para la Conservación de los Recursos Naturales (Natura). TNC manages the endowment fund itself, an evergreen fund that includes \$8 million from USAID, among others.

Poland

Polish American Freedom Foundation (PAFF) was established in 1999. Along with the foundation, a fund was established to continue some of the foundation's core programs. The fund also helps to solidify Poland's successful transition to democracy and free markets through initiatives to promote the development of the private sector in Poland. This evergreen endowment's funding is at \$80 million and is estimated to reach a potential funding of \$200 million.

South Africa

African Center for Constructive Resolution of Disputes (ACCORD) was established in 1992 as an education trust associated with South Africa's five historically black universities: Western Cape, Fort Hare, Transkei, The North, and Durban–Westville. The endowment fund was established in 1998 for the purpose of generating income to assure the sustainability of ACCORD's important efforts to bring conflict resolution to the forefront as an alternative to violence and protracted conflict. USAID provided \$5 million for the evergreen fund.

Swaziland

Swazi Business Growth Trust (SBGT) was a microfinance institution established in 1992 to extend loans to micro-, medium-, and small-business borrowers in Swaziland. The evergreen endowment, established in 1995, included \$5 million from USAID for the purpose of continuing the institution's programs and helping ensure its sustainability after the closing of USAID in Swaziland in 1995. This endowment was terminated in 1998.

Thailand

Kenan Institute Asia (KIASIA) was established in 1993. In 1996, USAID provided a \$3.5 million endowment to help establish a financially viable and self-sustaining institution to promote US and Thai development linkages.

PD-21 requires that endowment proposals be consistent with USAID objectives and approved strategies. *PD-21* also outlines some of the possible objectives that an endowment can hope to achieve:

- to broaden and enhance the funding base of an NGO
- to enhance financial stability to insulate the endowed organization from unpredictable government and donor agency budget fluctuations
- to attract other funds by increasing donor confidence
- to encourage the establishment of philanthropic principles in countries where such principles are less well established
- to institutionalize an activity, allowing it to continue beyond USAID funding
- to continue development strategies through international or indigenous groups upon termination of USAID presence

This list of six potential intermediate objectives or results can be collapsed into four broad categories:

- to initiate or sustain a project or activity
- to sustain or enhance the long-term planning, capabilities, and growth of an individual organization
- to develop or sustain a sector through grants to small groups, introduction of new players, and matching/challenge funds
- to leverage funds to bring in new funders/donors

The means to achieve these results varies by recipient organization. Nonetheless, it is interesting to note that despite variations in sector, type, and age of the endowments, all endowments reviewed seem to strive to achieve one of these results.

STRUCTURE OF THE ENDOWMENTS

INTRODUCTION

This section examines the structural components of an endowment — the primary characteristics and alternatives in design and implementation. The purpose of this section is to ensure a common understanding prior to the presentation of specific endowment examples in the operational experience section.

The structure of an endowment is best analyzed in three major categories:

- the structure of the recipient, which includes a discussion of the organizational profiles, governance systems, and internal financial management
- the structure of the endowment funds, including type of endowment, proposed intermediate results of the endowment, use of endowment funds, and investments
- the structure of USAID's role, including the grant agreement, the conditions precedent (CPs), the legal and regulatory aspects, monitoring and oversight, and recourse and termination

Each category is outlined at length below.

CATEGORY ONE: THE RECIPIENT ORGANIZATION AND ENDOWMENT PREPARATION

THE RECIPIENT

Implementing an endowment requires a recipient, a legal entity to receive the funds. The recipient can be a newly formed or a pre-existing organization. The recipient must have specific financial and managerial systems in place to allow it to receive and manage the endowment adequately. In most cases this includes an adequate accounting system; a contract for annual audits of all sources of funds; a core leadership team, including an executive director and a board of directors or trustees; and financial and programmatic plans.

PD-21 offers specific guidance regarding potential recipients of USAID dollar-appropriated endowments, for example, they must meet pre-survey award requirements and have a specified use for the endowment in line with programs and activities of the organization. It emphasizes the need for strong institutional development and indicates that at times, additional funding to strengthen management and financial systems is required. *PD-21* does not dictate the age or profile of a recipient organization, but does note that new and weak institutions tend to require higher degrees of monitoring and oversight, which in some cases indicates that an endowment is not an appropriate mechanism. In such cases, it recommends that a Mission or Bureau consider traditional forms of funding, such as a grant, until the institutional development of an organization has taken place and USAID is sure that an endowment is appropriate.

In practice, the recipients are almost as diverse as the endowments themselves. In addition to being in all regions and sectors, the history of the organizations and their history with USAID are varied. All endowment recipients are non-profit, though many are not registered formally with USAID as a private voluntary organization (PVO). This is partly due to the age of the recipient organization. Some recipients were new organizations, with no history or pre-established systems.

In the case of new groups applying for endowments, the endowment process is complex. The recipient organization and those at USAID must concentrate on the basics of organizational development — staff, finance, programs, and governance — while designing and trying to implement an endowment. In such instances, an institutional grant or other funding from USAID or elsewhere is often provided to build the required new systems prior to the signing of the grant agreement and the disbursement of funds.

Additional endowments were to pre-existing organizations that have longstanding relationships with USAID. USAID is currently using the endowment mechanism as a way to carry on the support they have granted to such organizations.

The third group of recipients includes those who were pre-existing entities, formed without USAID funds and well established prior to receiving an endowment. However, less than half of the recipients analyzed in this review fall in this category.

PD-21 requires that the recipient organization be non-governmental, that is, the government has less than majority control of the organization. The government can have some influence in an organization, provide or receive funding, or be represented on the board of directors. However, the majority of the decision-making authority cannot remain with the government if the organization is to be considered non-governmental.

All of the endowment recipients analyzed in this review are non-governmental, though many have allowable affiliations with the government, such as partial funding or government representatives on the board of directors. In a few instances, the government is part of a trust arrangement with the recipient organization, often serving as the trustor.

Finally, *PD-21* is meant to serve as guidance for recipients of endowments funded with appropriated dollars. It states that this includes endowments converted to local currency through debt swaps. However, there appears to be some confusion as to what appropriated really means. Does it include appropriations made through previous projects and Mission-level development assistance funding, or only those appropriations made directly by Congress for a given endowment? For the purpose of this review, all of the above are considered appropriated dollars funding an endowment.

Not all are direct dollar-appropriated endowments; some endowments were funded through direct appropriations, requiring congressional approval. Others were funded through a pre-existing mechanism, such as a grant with leftover funds. These endowments should still be considered funded with appropriated dollars, even if it was not a new appropriation specifically to establish a new endowment.

Table 3 offers a brief summary of the organizations that serve as the recipients for the endowments analyzed for this review, including their history and relationship with USAID.

Table 3. History of endowment recipients

Country/region	Name of endowment fund/recipient	Year established		Received USAID funds prior to endowment
		Recipient	Fund	
Armenia	AUA	1991	1999	Yes
Armenia	MACF	1994	2001	No
Baltics	BAPF	1998	1998	No (new)
Bangladesh	ICDDR/B	1978	1998	Yes
Bolivia	PROSALUD	1985	1997	Yes
Bulgaria	AUBG	1991	1997	Yes
Colombia	PROFAMILIA	1965	1993	Yes
Costa Rica	ARIAS	1988	1993	Yes
Ecuador	APROFE	1965	1998	Yes
Ecuador	CEMOPLAF	1974	1997	Yes
Ghana	GHCT	1996	1998	No, but USAID funded predecessor project (NRCHP)
Ghana	GSMF	1993	1997	Yes
Global	CARE	1945	1999	
Global	IPPF/EFS	1954	1997	Yes
Honduras	CADERH	1982	1995	Yes
Indonesia	KEHATI	1994	1995	No (new)
Jordan	ACOR	1968	1997	Yes
Mexico	FMCN	1994	1997*	No (new)
Panama	FIDECO	1995	1995	No (new)
Poland	PAFF	1999	1999	No (new)
South Africa	ACCORD	1992	1998	Yes
Swaziland	SBGT	1992	1995	Yes
Thailand	KIASIA	1993	1996	Yes

* Though FMCN was established specifically to manage the endowment fund, almost three years passed before funds were disbursed to it.

GOVERNANCE

A recipient organization is only as strong as the leadership and management in place to ensure that its programs, finances, and planning are on the right track. As a result, governance (the system of power, decision-making, and authority) is a key factor to organizational success and a critical factor for the recipients of USAID endowments. A well-defined and active governance structure allows for checks and balances and appropriate levels of oversight within an organization.

Most governance structures center around a board of directors or trustees. This group usually comprises prominent individuals in a given field or topic of concern to the organization. For example, an environmental NGO might have board members who are conservation specialists, water resource managers, and the like. Additionally, many boards have finance, legal, and international representatives to ensure legal compliance, reporting, and fundraising.

There are two types of governance structures for recipient organizations of USAID endowments. The types are based directly on the formation and history of the recipient organization. The first occurs when the organization was formed to receive an endowment for a specific purpose or activity. In this instance, the entity is the endowment, and governance of the entity is governance of the endowment. The second type occurs when an organization has multiple programs, has multiple sources of funds, or existed prior to receipt of endowment funds. In this instance, the entity is the endowment and more, and governance of the endowment is only one part of the entire governance structure of the entity.

In the first scenario, when the organization was formed to receive an endowment and initiate a program or strategy stemming from it, the board of directors is governing the endowment, as this is the entity. It is the board of both the recipient organization and the endowment, as these are one and the same. In this case, the board would still be concerned with financial and programmatic issues only as they relate to the endowment and not independent of it. Some of these organizations will establish a traditional committee structure, but all decisions will be in relation to, and not independent of, the endowment.

In the second scenario, the board of directors or trustees of the recipient organization has responsibility for all program, financial, and institutional decisions — both those related to the endowment and beyond. It will approve budgets and formulate strategies that may or may not affect the endowment. In these instances, the board usually establishes a committee structure, and each major component of the organization has a committee overseeing it. The committees, which are often internal, include representatives from the full board and the staff and usually operate in an advisory capacity, making recommendations to the board about particular items. In these cases, a finance or investment committee is often formed to support the management and governance of the endowment.

The majority of boards in both types of governance structures are active and make decisions about the endowment and other related programs. In some instances, however, when the board is inactive, not skilled in investments, or more interested in other programs of the organization, decisions regarding the endowment fall to staff of the organization.

Regardless of the arrangement, the group that governs the endowment — whether it is solely dedicated to the endowment or has a broader mandate — should not take this responsibility lightly. An endowment is a significant funding mechanism used to achieve a specified objective and has various regulations surrounding its implementation and use. Those governing it must have appropriate skills in finance and investments and be willing to meet with outside experts, trustors, and USAID as well as review performance reports. They must also ensure compliance with the grant agreement and standard provisions.

INTERNAL FINANCIAL MANAGEMENT

In addition to a strong governance structure, the recipient organization must also implement and utilize a system of internal financial management, including controls and management systems. Financial management is a key structural element of an endowment and one that the organization and USAID must take seriously.

In *PD-21*, financial management has two parts: financial controls of expenditures of funds and the adequacy of financial arrangements for investment of endowment funds. USAID uses the pre-award survey mechanism as a test of financial controls and an opportunity to assist the recipient organization in implementing appropriate financial systems. This is important because to financially manage the endowment, the recipient organization must be able to implement, manage, and account for funds expended without detailed oversight from USAID.

PD-21, however, does not dictate one specific financial management arrangement that must be employed by all endowment recipients. Rather, the endowment guidelines in *PD-21* define three types of internal financial management — trust, separate finance committee, and independent financial manager. Table 4 summarizes the key points of each option. An option should be selected based on the knowledge of finance and investment within the recipient organization.

Table 4. Internal financial management

Financial management option	Summary of key points of option
Trust	In a trust arrangement, control of the investment fund is totally separated from the beneficiary organization. A trustee may be a separate foundation, NGO, bank, or other entity. In some instances, a trustee organization is specially established to manage an endowment for a selected beneficiary. In the trust scenario, the beneficiary NGO has limited decision-making authority with regard to the actual investment of the endowment funds. The benefits include incorporating international experts in the decision-making process. However, such an arrangement does limit the beneficiary organization’s long-term capacity to control its own assets.
Finance committee	Recipient organizations with some capacity for finance and investments, either in staff leaders or board members, often form a finance committee. This committee, which often includes external financial and investment experts, is another way to ensure sound internal management of endowment funds. This committee can serve in an advisory capacity to the board or other governing body by making recommendations for decisions regarding investments, portfolio, and allocations. In this scenario, the NGO will rely heavily on the advice of the committee, but will have decision-making authority. If the finance committee is the preferred management mechanism, the details of it are often outlined in the grant agreement.
Independent financial manager	A third financial management mechanism is the retention of an independent financial manager who will advise the organization’s board and serve as the conduit with the selected asset manager. In this instance, the NGO has the ultimate decision-making authority. This option is most appropriate for advanced NGOs that understand the basics of investing, but want an outside expert to help navigate through the nuances. If the NGO opts to use the services of an independent financial manager, a written agreement must be executed, and USAID must approve the selection of this individual or firm.

In one arrangement, the recipient organization has the ability to fully implement, manage, and account for funds of the endowment. In other instances, where knowledge of finance is limited, the recipient organization’s management of finances is limited or curtailed. In these cases, an outside group or firm assists in financial management and reporting.

Internal financial management is an important part of the structure and management of an endowment. It requires significant finance and investment skills that some recipient organizations, especially those that are newly formed, often do not have. In these instances, some form of external assistance (either through a trust, committee, or independent manager) is appropriate.

CATEGORY TWO: ENDOWMENT FUNDS

Once the decisions are made regarding a recipient organization and its structure, including those of governance and financial management, decisions regarding the endowment funds themselves are next. They include items such as the type of endowment (evergreen or sinking), intermediate results, and use of funds and investments.

TYPES OF ENDOWMENTS

Recipient organizations, in collaboration with USAID, must decide whether to establish a sinking (limited term) or evergreen (in perpetuity) endowment. Each type has varying goals and, therefore, serves a different purpose for a recipient organization. A sinking endowment provides a stream of income, comprising the endowment’s interest and principal, over a specified period. This is the appropriate endowment type if a project or initiative has a specific timetable in which it can or must be completed. It is also appropriate if the recipient organization is expected to seek additional funding sources to supplement or replace USAID funds over time.

By contrast, if an organization has ongoing financial needs that cannot or will not be covered by other sources and USAID believes that continuous support is viable and necessary, then an evergreen endowment would be undertaken. In this instance, income from the endowment is used, and the principal is not invaded. Like the sinking endowment, an evergreen endowment also provides a stream of income, though it does so in perpetuity, ensuring the long-term existence of a program or organization.

PD-21 discusses the life or type of the endowment in general terms. It defines the types of endowments and notes that, at times, a sinking endowment is an appropriate avenue, though it does not prescribe one type over another. Rather, it indicates that retaining or spending down the principal will vary with each endowment recipient's goals and proposed uses and recommends that if a sinking fund is implemented, the minimum draw down period be 10 to 15 years. It warns that if a sinking endowment is drawn down too quickly, it will look less like an endowment and more like an advance of project or grant funds, which is unacceptable.

Of the 23 endowments analyzed in this review, only 6 (MACF, AUBG, BAPF, CADERH, GSMF, and CARE) are sinking funds, with terms that range from 5 to 20 years. Those implemented as sinking endowments were done so deliberately with the belief that the endowment goals could be fulfilled (or at least started) within a specified time frame. USAID's remaining endowments are evergreen endowments, providing steady income streams in perpetuity. Though the specific circumstances of each endowment vary, *PD-21* and those who review endowments indicate that an evergreen endowment is USAID's preferred type of endowment.

INTERMEDIATE RESULTS OF ENDOWMENT

Though the development objectives of each of the endowments vary, such as better reproductive health or improved air quality, the intermediate results are often quite similar and can be assembled into four broad categories:

- initiate or sustain a project or activity
- sustain an institution
- build or develop a sector
- broaden the funding base of an institution

Currently, no formal measurement of progress against these results seems to be used regularly. Nonetheless, indicators (such as number of grants, expanded program activities, or increased donor rosters) suggest that progress against results is being made.

USE OF FUNDS

Closely linked to the intermediate results that an endowment hopes to achieve are the actual uses of the funds. For each intermediate result, there is a common use of funds. In most cases, funds are used for one category, though at times, endowment funds assist in a variety of areas. Table 5 lists the intermediate results and the corresponding use of funds.

PD-21 does not delineate specific or approved uses for endowment funds. It does, however, note specific areas in which funds cannot be used. Prohibited uses include funds for abortion, involuntary sterilization, personal gain, or policy/legislative influence. Best efforts must be made to comply with US source/origin rules. These guidelines do mention, however, that the agreement between USAID and the recipient organization should outline the specific proposed uses for the endowment funds.

Additional mention should be made of endowments for a specific program or product. Normally, USAID funds these types of activities through a traditional grant mechanism. When organizations receive an endowment instead of a grant, it is usually to ensure ongoing support if specific Mission objectives are changing. Another reason is because the initiative/product or program is innovative or one in which USAID does not have any current or future programs. This, however, is the least common use of endowment funds from USAID.

The proposals and grant agreements for the endowments reviewed articulate the proposed result of the endowment and use of endowment funds. However, in some cases, the endowment income is neither being used as planned, nor at all. This is a positive factor in terms of growing the total endowment. However, there are potential challenges or risks associated with this practice of non-use that will be discussed later in this report.

Table 5. Intermediate results and uses of funds

Intermediate result	Use of funds	Description of use and examples from endowments reviewed
1. Initiate or sustain a specific project or initiative	Program- or project-related costs	Endowments in this category are diverse in terms of region and sector, but tend to be smaller in size than those earmarked for other uses (in most cases, a few hundred thousand dollars to \$1 million, as opposed to several million dollars). Examples of endowments in this category include MACF and ACOR.
2. Sustain and ensure longevity of an institution — sustainability	Operating costs, such as salaries and facilities, to cover the financial shortfalls in programs that regularly lose money	If the recipient organization is seen as providing a critical service in a given community, yet often suffers from financial shortfalls, endowment funds for operating costs are common. USAID will not approve the endowment if the shortfalls are seen as resulting from mismanagement. Rather, funds for operational costs are to cover the organization's inability to generate sufficient local income, for reasons such as serving the poor. Using endowment funds to cover operating costs is linked to the development objective of sustaining and ensuring the longevity of an institution. Examples of endowments in this category include AUA and AUBG.
3. Build, develop, or sustain a sector	Disbursement and management of grants	Endowments with this use allow funding to a number of small programs or NGOs worthy of funding that do not qualify directly for USAID funding. In these cases, USAID will provide an endowment to a local organization that will then design a grant program to screen, assist, and fund worthy initiatives in a specified sector. Use of funds for grant-making is directly linked with the development objective of building a sector. Examples of endowments in this category include FMCN, KEHATI, and FIDECO, as well as IPPF/EFS, BAPF, and PAFF.
4. Broaden the funding base	Marketing and attracting new donors	Often, funds are not used directly; rather, the reputation and contribution of USAID is used to draw in new sources of funds. Examples of endowments in this category include ICDDR/B and ACCORD.

SIZE AND COST

Once the recipient organization and USAID have decided upon the type of endowment, the intermediate results to be achieved, and the use of the endowment funds, the actual size of the endowment needs to be finalized. Though some may prefer to select a funding size first, this runs the risk of having an endowment that is too small and unable to cover the costs of the activities planned. *PD-21* does not specifically mandate or even offer guidelines regarding an appropriate size for an endowment. As a result, there are endowments as small as \$400,000 (MACF) and as large as a potential \$200 million (PAFF).

Though budget constraints, recipient organizational needs, and Mission/Bureau priorities all impact the amount of funds available, up-front planning will ensure that USAID and the recipient organization are clear on what can be implemented and accomplished

realistically with the endowment funds provided. For example, \$500,000 might not generate enough income after inflation and manager fee adjustments to design, manage, and implement a grant program.

In addition to the fund's goals, the cost to establish and maintain an endowment must be considered. An endowment is time-consuming and complex. The process involves USAID officials; recipient organization staff and board members; and often outside consultants, lawyers, and investment specialists. Tax-exempt status must be applied for; bank accounts, opened; and financial control systems, implemented. On an ongoing basis, there are also costs associated with maintaining an endowment: fees for asset management, preparation and submission of reports to USAID, and oversight time and expenses of USAID. These costs need to be factored into the equation. Though an endowment might not make millions for an organization, it should not operate as a loss.

INVESTMENTS

Once the proposed result, type, use, and size of the endowment funds are decided, the recipient organization must invest the funds. The investment of the endowment funds is the last structural component of the endowment related specifically to the funds themselves. Investing the funds involves several areas, such as the selection of a firm to invest the funds, selection of a portfolio in which the funds are to be invested, and goals regarding performance of the funds. In order to make informed decisions regarding use of firms and design of a portfolio, a number of key questions should be discussed to determine the best structure for the investments:

- What is the purpose of the investment? What is the hoped-for intermediate result?
- How will the funds be used? Operational costs? Grant-making?
- What is the goal of the investment? To maintain the value of the endowment funds? To grow the total?
- What is the projected or desired level of risk and anticipated rate of return?
- What is the time frame for use of the funds?
- What services are required to assist the recipient organization invest wisely?

The governing body of the recipient organization must answer these questions and decide on the most appropriate investment plan.

Though *PD-21* does describe the process of internal financial management, it neither defines nor specifies the need to hire external financial managers, such as an investment or asset management firm, to manage the endowment assets.

Instead, *PD-21* discusses specifics of the investments themselves. For example, it states that the endowment funds must be invested through a US-based financial intermediary in investment options that are available in the US market. This is not meant to restrict investing in international instruments; rather, it helps prevent investing in international markets that

are soft or risky. Additionally, *PD-21* requests that endowment funds be held in an account that is separate from all other accounts of the recipient organization. This will ease review of performance of the USAID-specific funds. Finally, *PD-21* indicates that though an endowment fund can earn and retain interest, the investments should be sound and prudent and not include any instrument of a highly speculative nature.

Though offering general guidance, *PD-21* concludes that each endowment will need to define and formulate its own investment policies, based on questions such as those listed above. These policies will assist the recipient when hiring an asset management firm and actually investing the funds.

Once the investment policy has been formalized, the governing body needs to select an asset management firm. In some instances, this is done through open competition; in others, an ongoing relationship presents a viable alternative. The investment policy, if articulated prior to selecting an asset management firm, will be one way for the recipient organization to know whether the prospective firms can achieve their endowment investment goals.

The asset management firm and its role are not to be confused with that of the independent financial manager discussed previously. The internal financial manager ensures that the recipient organization has appropriate financial systems and processes to control and account for the endowment funds and associated expenses. The asset manager actually will invest all or most of the endowment funds (buy stocks, bonds, or Treasury bills) and track the performance of these instruments over time.

Of the endowments reviewed, the majority of recipient organizations used some form of open competition to select an asset management firm. GSMF was the only recipient organization to utilize a full procurement procedure, issuing an open call for proposals in a global newspaper. In most instances, while the competition was open, the list of firms from whom proposals were requested was pre-determined by the board of directors.

Other recipients used the recommendations of board members or even other endowments to make a selection directly, without any form of open competition.

ASSET MANAGEMENT AGREEMENT

Once the asset manager is selected, an agreement between the recipient organization and the asset management firm must be negotiated. The agreement outlines the terms of the relationship, including reporting and fees. Asset management firms have standard agreements that were used as the basis for most endowments included in this review. However, most recipient organizations, in some instances with the assistance of USAID, added attachments or addendums to ensure that the agreement had provisions to handle the specific requirements of the recipient organization and USAID. Such provisions often related to reporting to both the recipient organization and USAID and clauses to protect USAID's legal rights relating to the funds.

The asset management agreement also outlines the degree of control that the selected firm has over the assets they manage. In most instances, the asset management firms prepare quarterly reports for the recipient organization in which all trades, investments, and instrument holdings are listed. In some cases, the asset management firms will have discretion to make adjustments to a given portfolio within certain parameters or under certain circumstances.

ASSET MANAGEMENT FEES: The asset management agreement not only outlines the limits of authority of the asset manager, but also the fee structure. In most instances, the management fee structures are standardized across a given asset manager. Fees are sometimes based on the total amount held in the endowment, or the amount of funds held in an investment portfolio. Of the endowments analyzed, the fees varied from 0.535 to more than 1 percent.

However, it is important to note that the asset management market is highly regulated, and different firms use different structures to recover their costs. As a result, the fee structures vary, but the end result is a fee range across different firms that is actually quite narrow. In almost every case, fees were based on a percentage of total funds invested.

Documents indicate that a number of the recipient organizations have changed their asset manager since the inception of the endowment. A few based the switch on poor performance. However, in most cases, a combination of the fee structure, the difficulty in communication, and the complex asset management reports prompted a switch. Usually, a smaller or non-competitive search was undertaken for the replacement of the asset management firm. It is interesting that when a second search process took place, some organizations selected firms that specialize in non-profit investing. These non-profit specialty firms were selected for their understanding of the circumstances, needs, and appropriate risk levels of non-profits and for their ability to provide simple reporting processes and accessible investment managers.

THE INVESTMENT PORTFOLIO: Once the asset manager has been selected and the agreement and fees, negotiated, the recipient organization and its asset manager must design an investment portfolio. The portfolio is the actual set of financial instruments in which the asset manager invests the endowment funds, including, but not limited to, stocks, bonds, and other fixed-income instruments (i.e., certificates of deposit, CDs). The portfolio of each endowment varies: Some have 70 percent or more in equity or stock-type investments, and others have 60 percent or more in fixed-income instruments. It is important to note that portfolio composition can change dramatically, based on market conditions, investment preferences, and financial needs.

In most cases, the recipient organization provides parameters to the asset management firm to open the portfolio. Then the board evaluates the mix at regular intervals, adjusting as needed or desired. The average split is about 60 percent equity, 40 percent fixed income. Most asset management firms would consider this type of investing as growth oriented with moderate to medium risk.

Though *PD-21* indicates that investments of a highly risky or speculative nature should be avoided, it does not identify what those risky instruments are. Therefore, each endowment recipient organization and its asset manager must define what is appropriate and what is speculative or high risk.

THE INVESTMENT'S PERFORMANCE: Once the endowment is invested in a portfolio, its performance must be tracked. In many instances, the recipient organization specified a target return in the asset management agreement or investment policies. Of the endowments analyzed, the target was 4 to 10 percent. This range, though, is not easy to compare, as documents did not always clarify whether target returns were inclusive of inflation or asset management fees or based on any sort of benchmark.

Additionally, target returns have limited value unless they are tied to a benchmark. The use of benchmarks such as Moody's or Standard & Poor's is an effective way to gauge asset performance. In fact, most asset management firms use benchmarks to check the performance of a given portfolio.

Of the endowments analyzed in this review that had stated target returns, actual returns were less than the targets. However, it should be noted that these hoped-for returns were only targets.

Market factors, such as an economic slowdown (currently in process), can dramatically affect market returns. Markets can fall, and endowments can lose money. Investing is a risk, with both highs and lows. Endowment portfolios are not immune to these risks, and recipient organizations should be aware of this when investing.

CATEGORY THREE: USAID AND ITS ROLE

There are three major entities in an endowment: the recipient organization, the asset management firm, and USAID. The previous two categories discussed the endowment structure as it related to the recipient organization and the investments, including the asset management firm. This category examines the role of USAID in the entire process, from review and approval of the original proposal to recourse and termination in the case of failed endowments. Subsections include the grant agreement, conditions precedent, legal and regulatory requirements, monitoring and oversight, and recourse and termination.

PD-21 is the primary means through which the details of USAID's role are defined. However, these guidelines come into play at the approval stage of the endowment. *PD-21* does not discuss the pre-approval or planning and proposal stages, which might include discussions, reviews, or site visits in which USAID plays a key role. In many cases, a potential recipient prepares a proposal that goes through many iterations with USAID before the designated technical officer deems it ready for the approval stage.

Once USAID and the recipient group deem the endowment proposal ready for approval, *PD-21* requires that it be sent for review and approval to PPC and GC. Once these two groups have signed off (which, again, may be an iterative process, depending on feedback from these two groups), the proposal can be submitted to the appropriate Bureau administrator for approval. The remaining guidelines in *PD-21* help USAID and the recipient organization move the endowment from the approval stage to the implementation and disbursement stage.

GRANT AGREEMENT AND STANDARD PROVISIONS

Once an endowment is approved, the first document that solidifies the endowment and outlines the terms of funding is the grant agreement. The GC (of a Mission or regional-level legal officer) and a representative from the Office of Procurement (OP) are usually the primary drafters of such an agreement. This agreement between the endower (in this case, USAID) and the endowed (the recipient organization) outlines the rationale for the endowment and all specific terms relating to use of funds, type of endowment, and investments and clarifies USAID's oversight role and its recourse rights. In essence, it defines the legal relationship between the two entities and delineates all terms of the endowment, including any required conditions prior to disbursement of funds, and maintenance, including reporting, monitoring/oversight by the endower, and evaluating the endowment.

Attached to or incorporated into all USAID grant agreements that establish endowments is a set of standard provisions covering such items as financial reporting, audits, and use of funds.

CONDITIONS PRECEDENT

Within each grant agreement, USAID outlines a set of conditions precedent (CPs) that must be fulfilled prior to the disbursement of endowment funds to the recipient organization. Through fulfillment of the CPs, USAID ensures that the proposed recipient organization has the systems in place to receive and manage endowment funds. *PD-21* mandates the inclusion of the following (at a minimum):

- **conditions precedent:** (1) a detailed financial plan that includes a realistic projection of amounts and uses of income from the endowment and (2) a management plan for the endowment fund that includes an executed trust agreement, financial management contract, or formation of a finance committee
- **covenants:** (1) during USAID's oversight period, no changes to the trust agreement, financial management contract, or other management plan documents can be made without USAID approval and (2) if the NGO or the endowment is dissolved at any time, even after oversight, any funds remaining in the endowment must be returned to the US Treasury

In addition to these standard CPs and covenants, most endowment grant agreements outline additional CPs relating to the history and specifications of the recipient organization. For example, in instances where USAID has had an ongoing relationship with the proposed recipient, the CPs are often few in number. In instances where the proposed recipient is a new organization or new to USAID, the CPs tend to be more numerous.

Normally, fulfillment of CPs was mandated within one year of the signing of the original grant agreement. Extensions were regularly requested, especially when 501(c)(3) status was mandated. Generally, recipient organizations were able to complete the CPs within 18 months. In the case of GHCT, the process took almost five years as new Mission staff requested additional CPs prior to fund disbursement.

In addition to CPs prior to disbursement of funds, there are also cases of required CPs prior to the use of endowment funds. For example, GSMF must achieve a specified level of CYPs and cost recovery before USAID will allow access to endowment income or principal.

LEGAL, TAX, AND REGULATORY REQUIREMENTS

The grant agreement and the CPs are means through which USAID can ensure compliance with all legal, tax, and regulatory requirements. These requirements are some of the most complex aspects of establishing an endowment, be it dollar or local-currency denominated. However, they are critical to the successful implementation and ongoing success of the endowment.

PD-21 notes that an endowment is not a familiar funding arrangement in many developing nations. Furthermore, the framework for establishing and maintaining an NGO also varies. Consequently, some NGOs must adjust their founding documents, such as bylaws, charters, or articles of incorporation, and include additional language about financial management, conflict of interest, and governance to ensure compliance with various laws. The guidelines, therefore, recommend consultation with local legal counsel or outside consultants early in the process if the endowment mechanism is wholly unfamiliar. Only through this process will the local legal, tax, and regulatory issues be fully understood and complied with accordingly.

US tax and legal issues are also discussed in *PD-21*. It indicates that establishing an endowment comes with a number of tax consequences — especially tax-exempt status and the deductibility of contributions. Though the legislative changes in the early 1990s allowed NGOs to earn income from USAID funds, this income is not automatically tax-free. *PD-21* notes that a separate information packet devoted to US tax issues has been prepared and that USAID Missions, Bureau staff, and recipient organizations can use this information to navigate the process.

The US 501(c)(3) tax-exempt status, issued by the US Internal Revenue Service, allows for recognition as a charitable organization, which will allow income to be earned on investments tax-free. *PD-21* notes that it can take a minimum of three months to process the application for this status and that a review of financial controls and accountability is part of this process. USAID considered this point so critical that many grant agreements have listed obtaining US tax-exemption status as a CP.

Though organizations can apply for tax-exempt status on their own, most US-based NGOs employ the services of an attorney well versed in these issues. The costs to obtain this exempt status can be high — several hundred dollars for all required filing and fees and often thousands for legal advice and assistance.

The tax, regulatory, and legal aspects of the recipient organization and its endowment must be successfully navigated to ensure compliance. In some instances, the local and US laws are compatible, but in others, the process is not as easy. Unfortunately, many international NGOs are unfamiliar with US tax codes and non-profit laws, which requires additional time and attention to these details. Furthermore, the specifics of obtaining this status are often not clearly delineated in the individual endowment grant agreements.

As a result, recipient organizations have dealt with this issue differently. In some instances, the proposed recipient — an international NGO — has applied directly for such status. Other recipients have chosen to set up shell organizations in the United States, and the shell has obtained this status. Finally, those endowments set up as trusts require that the trustee, not the beneficiary, obtain tax-exempt status.

USAID MONITORING AND OVERSIGHT

Monitoring and oversight of the endowment is the key area of USAID's involvement with the recipient organization. Monitoring and oversight involves both reporting on the part of the recipient organization and advisory duties for USAID, the purpose of which is to ensure compliance with the grant agreement and other provisions, adequate planning and forecasting of income and program decisions, and proper spending of endowment assets.

The *PD-21* guidelines note that the grant agreement should establish a set period of oversight and recommends a minimum of 5 and a maximum of 10 years for such a period. During this period, USAID will remain informed of the programs, finances, and management of the recipient organization as it relates to the endowment.

However, the specific degree of monitoring depends on the history and track record of the recipient organization. Furthermore, monitoring and oversight of an endowment is different from that of a grant; if grant-type oversight is required, an endowment might not be appropriate. However, no clear definition of monitoring and oversight is offered, as it is stated to be organization and circumstance specific. As a result, each of the endowments offered slightly different timelines, terms, and requirements regarding oversight. In most cases, they are discussed in three separate segments: pre-disbursement, oversight, and post-oversight. Reporting requirements and oversight responsibilities are outlined for each of those three segments within the individual grant agreements.

PD-21 does specify a few areas where USAID oversight might be appropriate, though it does not mandate the use of any or all such items. Potential areas of involvement include the following:

- USAID participation on the board of directors or as part of the governance structure, though in a non-voting or ex-officio capacity
- USAID approval of the first roster of the board (but not subsequent rosters)
- USAID receipt and review of select annual reports or annual plans related to the endowment

The role of USAID representation in an ex-officio capacity on the board or governing body of the recipient organization seems to be a common way to ensure information flow, as well as compliance with the grant agreement. The majority of endowments in this review outline this option in the grant agreement, though it is not always exercised.

In some instances, the Mission director or Mission designate serves as the ex-officio representative. In others, representatives at USAID/W serve in this capacity. Finally, in some cases, USAID representatives were active in the early years of the endowment, but no longer attend board meetings. The recipient organization also has responsibilities in terms of USAID's monitoring and oversight, primarily reporting to USAID with an agreed-upon set of reports at regular intervals.

PD-21 neither specifies nor mandates the management location of USAID oversight of an endowment. Therefore, some endowments are managed at the Mission level while others are from USAID/W. Some endowments have a global focus or include those in non-presence countries, which is why oversight is at USAID/W. However, some are managed in Washington even though the host countries have large and active Missions. Presently, oversight for these endowments takes place at USAID/W, and due to geographic location and competing priorities, the oversight is often not as rigorous as if it were done at the Mission level.

Throughout the course of our research and analysis, the concept of arm's-length oversight came up frequently. In the case of an endowment, regular reports, ex-officio representation, and initial approval of items such as the asset manager or investment policies might be the extent of USAID involvement. However, this type of oversight is not the same when endowment recipients are also recipients of other forms of USAID funding through grants or other project support. Several recipients also have grants or other arrangements with USAID. In these instances, additional reporting and oversight requirements exist for those additional funds, and USAID is aware of and involved in the detailed operations of the organization, much more so than if the organization was an endowment recipient only.

USAID oversight of the endowment is complex, with many components and variations. The degree of oversight depends largely on the trust and history between USAID and the recipient organization. Consequently, all endowments are not handled in the same way.

RECOURSE AND TERMINATION

One of the last items that *PD-21* mentions regarding the rights and responsibilities of USAID relates to recourse and termination. The guidelines indicate that the grant agreement should include specific language regarding USAID's options if funds are misspent. It mentions specific conditions under which termination is acceptable, such as failure to provide required reports or serious adverse audit findings.

In fact, the standard provisions accompanying a grant agreement articulate USAID's termination and recourse rights. They state that regardless of the status of the actual monitoring and oversight period, if the recipient organization dissolves, USAID retains the right to an immediate refund of all unexpended funds of the endowment. Additionally, it notes that at any time during oversight or for a period of additional years (5, 10, or in perpetuity, based on risk), USAID can terminate the endowment and request the return of funds under the following circumstances:

- mismanagement or misspending of endowed funds
- adverse findings during annual audits
- lack of adherence to the grant agreement, including reporting and management requirements
- inability to fulfill CPs within the approved time frame

Terminating an endowment is a serious undertaking. It demonstrates significant problems or gross mismanagement of an endowment. USAID has exercised this option in a few such instances, but does not do so lightly.

All grant agreements outline the process and rights of USAID should termination be required. In most cases, the endowments are still fully functioning.

3 Lessons Learned

LESSONS LEARNED

Analysis of more than 23 endowments spanning a variety of regions and almost one decade yields a wealth of lessons learned. This section presents lessons learned in subsections corresponding to those of the previous two sections. Following this presentation, general lessons learned about USAID endowments and the policy guidance in *PD-21* are outlined.

CATEGORY ONE: THE RECIPIENT ORGANIZATION

RECIPIENTS

- Design, implementation, and management of an endowment are not easy and take time. They require established financial, programmatic, and managerial systems within proposed recipient organizations. Many endowments analyzed were to new organizations that needed to develop such systems from scratch. For these recipients, the process was often lengthier and more cumbersome, as basic organizational development was done under a deadline and alongside a variety of other conditions that USAID required for the endowment funds to be disbursed.
- Funding from USAID to develop or upgrade organizational and financial systems, or to hire outside technical assistance in the early stages of the endowment process, is helpful. The funds allow for guidance from experts and strengthening of financial controls and reporting capabilities.
- Using a consultant, consulting firm, or international NGO to develop systems and co-design the endowment was beneficial for the new organization. This was especially true when those assisting the potential recipient were familiar not only with the endowment mechanism, but also with USAID and its requirements under *PD-21*.
- Strong leadership and management within the potential recipient organization are critical. If the leadership falters, the organization will falter and the endowment will fail. Proactive leaders who can network, market, and collaborate with other organizations or governments help build organizational credibility.

- Business and financial acumen on the part of the organization's leadership (staff and board) are most helpful for the ongoing management of the endowment. Technical experts, though fully aware of the issues, can easily lose sight of the fact that an endowment is fundamentally a funding mechanism requiring financial expertise.
- The recipient's relationship with USAID is key. Trust must be built on both sides. This is more of a challenge when the organization is new, or new to USAID. However, USAID Mission officials can also act as key advocates on behalf of the organization with USAID/W personnel and with approval processes.
- The organization must be seen as a credible, transparent, and legitimate entity within a given nation and accountable to its stakeholders. If it is seen solely as a vehicle of USAID or an elitist group, the endowment could have limited success, especially if its purpose is to build/sustain an organization or a sector.

GOVERNANCE

Governance systems, and the role of the endowment board, work differently across regions and nations. In some instances, the board members understand their role to be integral in decision-making, approvals, and strategies. In other cases, the board is seen as a rubber stamp, and it is the duty of the staff leadership to make decisions and approvals.

- Involvement of prestigious individuals is a great asset and may be critical to the success of the endowment.
- Composition and role of the board of directors can have a profound effect on the organization. The board is often more concerned with the programmatic areas of the organization. Managing the endowment from a financial and managerial viewpoint may often be secondary to the board.

INTERNAL FINANCIAL MANAGEMENT

As the endowment mechanism is different from that of a traditional grant or project funding, the recipient organization must understand both its internal capacity and its limitations in terms of international financial management.

- Internal knowledge by staff and board members of business, investing, and finance allows for greater understanding of the endowment mechanism and more informed decision-making. Organizations with such internal knowledge are more comfortable with the endowment mechanism and find establishing and managing it easier. In these instances, the organization's leadership can interact directly with the asset management firm to negotiate fees and evaluate performance.
- An organization that receives other funds from USAID is not automatically an appropriate candidate for an endowment. Success under other funding mechanisms does not prove the organization's ability to handle an endowment.
- Institutional knowledge at the recipient organization and USAID allows for adequate monitoring and oversight of outside advisors hired to assist with endowment management and decision-making. Poor performance of these hired experts can then be caught and dealt with early.
- The organization must be flexible, willing to make tough decisions, and change based on the performance of the endowment funds — for example, if the endowment does not earn income in a given year, programs or plans can be adjusted accordingly.
- Knowledge of US investments and USAID regulations is limited, both in the potential recipient organizations and with USAID representatives (such as technical officers and Mission representatives). As a result, outside consultants must be hired to avoid reinventing the wheel throughout the endowment process.

CATEGORY TWO: ENDOWMENT FUNDS

TYPES OF ENDOWMENTS

Most endowments approved by USAID are evergreen. Therefore, this endowment type predominates our review. It appears that several organizations and some individuals within USAID believed this to be the only true kind of endowment. In many instances, however, a 15- or 20-year sinking fund might provide an opportunity for USAID to offer significant support, while requiring the recipient organization to search for additional sources of funds if activities are to continue beyond the endowment term.

- Clarity regarding the specific use for the funds will ensure that the appropriate type of endowment is designed and implemented. An evergreen endowment need not be the default type. In some instances, another financing mechanism might be appropriate, especially given the time and cost required to establish an endowment.
- Potential recipients should look to similar organizations for model endowments. For example, an international university looking to set up an endowment might study the experience — the structure and lessons learned — of US universities that have endowments, to better understand the common types, the uses, and the challenges.
- The type of endowment should correlate with its size. It is doubtful that an evergreen endowment that is under or close to \$1 million will generate enough income to exclusively sustain any program or organization.

DEVELOPMENT OBJECTIVES

Each Mission and Regional Bureau has specific goals and development objectives for establishing endowments. One of the endowment objectives is leveraging funds or expanding the funding base of an organization.

- An endowment is not seen as a direct vehicle to achieve development objectives, such as improving the environment or health. Grant agreements discuss such objectives, but the mechanics of the endowment and the results are more often intermediate — to facilitate grants, to build a sector, and the like.
- The endowment offers a funding mechanism in which a local government can participate and provide funds to an area that is considered a priority.
- Funds from USAID add credibility to an organization and often serve as a catalyst for funding from other sources.
- Obtaining funds from foundations and other donors for an endowment fund — especially one meant to sustain an organization, rather than for a specific program or product — is difficult. Most donors want to see the direct impact of the funding they provide. Endowments are able to raise funds for projects, but not for the endowment; therefore, achieving their endowment growth goals are not as easy as originally anticipated.
- An unrealistic time frame for the endowment to attain broad development objectives often limits or hides the immediate impact. The results of an endowment often cannot be seen in a 1-, 5-, or even 10-year period; USAID should not expect such objectives to be met.

USE OF FUNDS

Each of the four primary uses of endowment funds (operating costs, grants, program or initiative costs, and fund leveraging) has various lessons learned, as the structure and design of endowments with each of these three uses varies.

OPERATING COSTS

- Clear and accurate budgeting is required to ensure that the amount of the endowment and the rate of spending of endowments of this type are sufficient and used properly. Spending rates for these types of endowments must be flexible to allow for changes in programming, funding, and staffing.

GRANT-MAKING

- Grant-making programs are time-consuming; the grant-making organization must have sufficient skills and capacity to manage the program.
- Small organizations that otherwise would not receive funds directly from USAID are eligible through this mechanism. They are able to expand or solidify their programs as a result.
- Grant-making allows USAID's money to reach more local initiatives and broaden its support to a given nation or sector.

SPECIFIC INITIATIVE OR PROGRAM

- Through this mechanism, USAID can be involved in sectors that it would not be involved in otherwise.
- If USAID funds are not sufficient to cover the costs of the initiative or program, specific plans must be in place to obtain the remaining funds and ensure that USAID's funds are used for the intended purpose.

INVESTMENTS

Investing the endowment funds is one of the most important aspects of the endowment experience. The selection of the firm and portfolio mix has an impact on the performance and growth of the funds. In general, this is the area in which both USAID and the recipient organizations feel the least comfortable.

THE ASSET MANAGEMENT FIRM

- Recipient organizations often design a short list of potential firms and send the request for proposal (RFP) only to those groups, instead of engaging in a more open competition in which lesser-known firms can compete. Though this method speeds up the competitive process, the result is that larger and big name asset managers are selected, as smaller firms or those that specialize in non-profit asset management are not considered.

- Recipient organizations often select big name asset management firms believing that this is an effective way to gain higher returns. However, complex monthly reports and limited communications often result in dissatisfaction, leading to asset manager turnover.
- Asset management agreements are often standard, and the recipient organization and USAID must work with the selected firm to ensure that the specific needs of the endowment are delineated and met. For example, the grant agreement and standard provision requires that certain investment reports be sent to the recipient organization and USAID; this provision must be added to most asset management agreements. Additional language about the rights of termination and recourse for USAID often are inserted as well.
- Fees often are standardized among the larger asset management firms (in only one instance were the fees negotiated to a lower rate). Most fees range from 0.6 to 1.0 percent of total assets under management. Though fee structures vary based on the size of the endowment and the percentage charged varies for equities versus fixed-income instruments, most industry practices tend to minimize the range in total fees across larger firms.
- Each firm has varying levels of control in terms of the portfolio, trading, and so on. In some cases, the recipient organization can only offer preliminary guidelines, but does not approve or necessarily even know about adjustments in their investments. In other instances, the asset management firm makes recommendations, but the recipient organization has to approve every transaction. This distinction is crucial, because the asset manager can make trades at a high commission rate, especially if the fees are on a per-trade basis. In these instances, endowment funds are wasted on constant or high trading fees.
- The role of the asset manager can shift from one of investment advisor to one who merely holds and transfers funds, but only if there is a competent and trusted financial advisor involved and there is a sophisticated understanding of investments on the part of the recipient organization. This latter arrangement may improve communication and discussion because of language issues and physical location of the asset manager and may be considerably less expensive to the recipient.
- Large asset management firms often subcontract or farm out management of certain portfolios. In these cases, an endowment recipient might hire a name firm only to have one or two smaller affiliated firms actually manage the assets.

THE INVESTMENT PORTFOLIO MIX

- USAID representatives and recipient organizations often do not understand the implications or options in designing the investment portfolio mix. As a result, portfolios might be risky or include non-acceptable instruments (such as tobacco stocks).
- To maintain the real value of the principal, a percentage of the income earned should be reinvested. Additionally, USAID and the recipient organization must clarify the goals of the investments (e.g., create a steady income stream, maximize potential returns, minimize potential losses). The investment goals will indicate to the asset manager how much risk the recipient is willing to tolerate (in terms of risk versus returns) and how to design a portfolio that responds to the recipient's current and future needs.
- A prudent portfolio will vary, based on the recipient organization and the asset management firm. Portfolio allocations differ considerably: Some have 70 percent in equities, others have an equal percentage in fixed income, and others have high cash holdings. As the goals of each endowment differ, one cannot prescribe an ideal mix, although the recipient and its advisors should provide guidelines. The value of an informed and dedicated investment committee for the recipient organization should not be underestimated.

THE INVESTMENT'S PERFORMANCE

- Many recipient organizations expect returns from an endowment on an annual basis, though this is not guaranteed. The endowment can lose money based on market fluctuations. Planning must accommodate certain variability in returns. Recipient organizations must understand the risks of investing and design annual investment plans with contingency options.
- Performance varies: In the mid-1990s, many endowments did well, and these endowments grew. In recent years (especially in 2001), however, the market has fallen. Many endowment recipients who had stock-heavy portfolios scrambled to adjust their portfolio to a more stable source. This may cause future endowments to be more cautious and ensure that endowments minimize potential losses. Conservative portfolio adoption, however, may also decrease the opportunities for higher returns.
- Successful completion of CPs provides USAID with some assurance that the recipient organization can handle the endowment and responsibilities brought with it.
- Inability to fulfill CPs or lengthy delays might indicate that the organization or sector is not appropriate for an endowment at that time.
- The variety of CPs outlined in the grant agreements is a reflection of the trust between USAID and a recipient organization. Recipient organizations that have previously received funding from USAID often have simple or easily achievable CPs. For these, the CPs cannot effectively serve as a means to determine the ability of an organization to handle an endowment, irrespective of its history with USAID.
- Recipient organizations are often unfamiliar with the process to fulfill some of the CPs, and models to follow are not readily available.

CATEGORY THREE: USAID AND ITS ROLE

GRANT AGREEMENT AND STANDARD PROVISIONS

The grant agreement and standard provisions are USAID's way of protecting its investment. Lessons learned in this area include the following:

- Clarity of responsibilities and expectations on the part of USAID and the recipient organization is critical to prevent confusion or misunderstanding.
- Legal and technical officers within USAID design documents differently. When staff at a Mission change in the midst of an endowment process, the endowment can be delayed, as different or new requirements emerge.

CONDITIONS PRECEDENT

Most endowment recipients see the CPs as necessary evils. However, from USAID's perspective, CPs ensure that controls are in place to implement and manage the endowment.

LEGAL, TAX, AND REGULATORY REQUIREMENTS

All endowments have dealt with the legal, regulatory, and tax issues. These are the most cumbersome, costly, and difficult aspects of the endowment process.

For new organizations established to receive endowments, a number of systems, processes, and documents need to be completed prior to filing for 501(c)(3) status. They include such items as bylaws, a board of directors, a management and financial system, and external audits. Only after these items are finalized can the 501(c)(3) process even begin, which adds to the time between the signing of the grant agreement and the disbursement/receipt of endowment funds.

Lessons learned in this area include the following:

- Local legal structure can inhibit or hinder the implementation or success of an endowment.
- Local opinions regarding NGOs and the influence of USAID within this sector can hinder the process and its success.

- Some organizations, especially those in Africa and Asia, were established using a British legal and non-profit model. Adjusting the organizational structure to a US model is required prior to applying for an endowment and lengthens the process.
- US tax and non-profit laws and requirements are not always understood by USAID or the recipient organization.
- The role of the USAID individual serving in the ex-officio capacity may not be clear to that individual or to the recipient organization. Advice from this individual during board meetings is at times mistaken for USAID's formal approval.
- The practicality of institutional memory, record keeping, and competing priorities seem to indicate that once the oversight period is completed, the endowment and the recipient organization are forgotten unless it receives additional funds from USAID. In turn, in many post-oversight cases, the recipient organizations seem to forget about USAID as well. This could pose a problem if the organization is dissolved or has a crisis, as documents would not be available.

USAID MANAGEMENT AND OVERSIGHT

- Arm's-length oversight is not a clear concept, meaning different things to different people. Some technical officers at USAID manage the endowments as if they were grants, having regular and detailed communications with the recipient organization. In other instances, technical officers do not involve themselves with the organization and its endowment unless a problem arises or help is requested.
- USAID staff assigned to manage endowments often collect the required documents, but are not consistent in their review of them. Some focus exclusively on the programmatic reports and request clarification relating to indicators and progress against strategic objectives. Others collect the asset management reports, but believe that the details of the portfolio are the responsibility of the recipient and not USAID.
- When an endowment is in a specific nation — and both the Mission and USAID/W are involved in oversight — confusion on the part of the recipient organization often results. Information flow is not always smooth between the Mission and USAID/W regarding these endowments.
- Management and oversight is often more focused on the programmatic side of the recipient organization as opposed to the management structure or performance of the funds. Financial controls, management, and performance are often overlooked, and potential challenges or problems can be missed.
- Having an influential USAID representative serve in the ex-officio capacity can help USAID maintain information flow and influence on key issues. It also demonstrates USAID's commitment to the endowment and the organization.
- Oversight is confused when a recipient organization has both grant/project funding and an endowment. In most cases, the recipient feels punished or restricted with the grant as compared to the endowment. The arm's-length notion of oversight is negated in these instances. In interviews with FMCN leaders, for example, they indicated that receiving a grant after an endowment felt like a punishment. With the endowment, however, they had freedom of decision-making and planning, with the requirement of keeping USAID informed. With the grant, FMCN must gain approval for all major decisions, and USAID is more involved in the details of the daily activities of the organization.
- USAID oversight is complicated when information is scattered throughout the agency. PPC and GC often have copies of the early records of an endowment, as their approval is required. Technical officers often maintain copies of annual reports and plans. GC often has copies of grant agreements and any asset management agreements they helped draft. However, no central clearinghouse exists that maintains a complete file for a specific endowment or for all endowments.
- USAID oversight takes on a different meaning when the endowment is part of a graduation strategy. In these instances, the endowment is not necessarily linked to a pre-existing or ongoing activity. Oversight must then take place in USAID/W, and the level of interest/involvement with the recipient organization is usually less than that with nations in which USAID has a presence.

RECOURSE AND TERMINATION

- The process of recourse and termination is not clearly outlined. As most endowments are new and still covered under the oversight period, USAID has not delineated the steps in termination. However, the termination of two endowments warrants the design of a specific process for termination, which recipient organizations should know.
- USAID has the right to terminate and request its funds at any point, during or after oversight. This is not fully understood by all recipient organizations. Theoretically, if a recipient organization dissolves 50 years after oversight ends, USAID has the right to terminate the endowment and request recourse. Actually implementing termination will be a challenge if documents are not readily available and those with any experience with the recipient organization have long since moved on.
- Consistency of termination should be maintained. If the grant agreement outlines specific instances under which termination should take place, and these instances occur, termination should be sought. The recipient organization should clearly understand the responsibility of an endowment and the ramifications of non-compliance.

USAID AND ENDOWMENTS

- *PD-21* offers guidelines for dollar-appropriated endowments. It responded to legislative changes of the early 1990s, as endowments became an increasingly popular long-term funding mechanism. However, the varied experiences of the endowments seem to indicate that the guidelines could be improved.
- Though *PD-21* delineates most of the structural topics of an endowment, it does not offer specifics and might be considered vague at times. This lack of specificity had a purpose: to allow some flexibility within the mechanism, knowing that individual circumstances can vary. For example,

when investing funds, *PD-21* states that the portfolio mix should not be overly risky or speculative. However, it does not define or even offer parameters regarding risk and speculation. As such, some portfolios include mainly fixed-income securities (a less risky portfolio) while others invested the majority of their portfolio in equities (a riskier option).

- Several individuals who manage endowments are neither aware of nor familiar with *PD-21*. When interviewing technical officers at USAID who manage endowments, some indicated that they became familiar with *PD-21* only when they were contacted as part of this review. Additionally, during these interviews, some technical officers, as well as some of the recipient organizations, were not fully aware of the reporting or oversight requirements listed in *PD-21*.
- The adherence to, or application of, *PD-21* guidelines depends on the Mission and individuals involved. Missions with legal officers who are familiar with *PD-21* and the endowment mechanism, or representatives in USAID/W who have been involved in previous endowments, help the process run smoothly. However, staff changes or lack of familiarity with the endowment mechanism may delay the process.

SIZE AND COST

Endowments are a costly and time-consuming undertaking. During our research, we attempted to quantify these costs. Arriving at a specific number or range of costs proved difficult as documents could only reveal the time span of the process and not the level of effort by specific individuals.

Anecdotal information reveals that the process normally takes 18 to 24 months from proposal to agreement (phase one) and 12 to 18 months from agreement to disbursement (phase two). The level of effort for the key technical officer at USAID is usually about 3 months full-time, spread out during

phase one, and 6 months full-time spread out during phase two. Representatives at OP, GC, and PPC spend additional time on the endowment. The recipient organization usually spends about double the time of USAID and often has at least one person devoted full-time to the process during both phases. Board members, outside consultants, lawyers, and other experts incur additional costs.

USE OF ENDOWMENTS

Several of those interviewed were skeptical about endowments and/or believe that this mechanism should be used only in rare circumstances. Interviews revealed that some of the skeptics included those who had helped implement an endowment. However, it appears as if those who are most skeptical seem to be those who do not fully understand the mechanism, believe it to be difficult or cumbersome, or have only heard of the problems associated with it.

KNOWLEDGE OF SPECIFIC ENDOWMENTS

Some endowments have gotten lost in the shuffle, with few, if any, individuals either aware of their existence, or able to offer information about them. The Introduction mentioned several in Madagascar, the Ivory Coast, and Nepal (among others) for which many attempts were made to locate key individuals or documents, but with no success. This lack of knowledge and sharing of information underscores the need for better reporting processes and regular review and monitoring of existing endowments, as called for in *PD-21*.

4 Recommendations

RECOMMENDATIONS

PD-21 is meant to provide guidance for the complex process of designing and implementing an endowment. It offers general guidance on a number of topics related to the structure and processes of the endowment.

However, the experience of the endowments analyzed demonstrates that there are areas not fully addressed in *PD-21*, as well as areas that require clarification or elaboration. Therefore, we recommend amending and re-writing the policy guidelines. Many of the recommendations outlined below can be articulated in a revised *PD-21*, the result of which will be a clearer, more user-friendly document for USAID Missions, other USAID organizations, and recipient organizations.

CATEGORY ONE: THE RECIPIENT ORGANIZATION AND ENDOWMENT PREPARATION

THE RECIPIENT

POTENTIAL ENDOWMENT RECIPIENTS MUST BE SCREENED: The recipient is one of the most important keys to an endowment's success. Selection and screening of potential recipient organizations is important to ensure that they are prepared to handle the complexity of an endowment. Even if the endowment structure is well designed, the endowment can fail if the organization is weak, mismanaged, or not respected in the community. Therefore, the first step is to gauge the recipient organization's endowment worthiness.

PD-21 defines some of the areas to review in an organization prior to implementing an endowment, including governance, financial management, and planning. If an organization is not a registered PVO, a pre-award survey is required. Though the pre-award survey covers most basic areas of organizational development, it is not geared to endowments. Furthermore, if the organization is familiar to USAID, a new pre-award screening is not normally conducted prior to implementing an endowment.

The screening process should be required for approval of any endowment proposal. It should be conducted by an independent person, either internal to USAID or an external consultant who is knowledgeable in investments, endowments, and NGOs. The screening should not be conducted by any individual previously or currently involved with the organization or USAID's oversight to ensure objectivity and accuracy.

Some of the criteria in this screening process include the major components of organizational development and questions about USAID's history with the potential recipient:

- history of the organization
- governance structure, including skills in endowments, business, investment, and finance
- staff leadership, including assessing business, investment, and finance skills and the ability of those charged with day-to-day financial management of the endowment
- conditions in the host country, including attitudes toward NGOs and this organization in particular
- reputation within the community
- history with USAID (Has it been a grant recipient? If so, how did it perform programmatically and in terms of reporting?)
- financial review or review of most recent audit
- clarity of purpose, planning, and programs
- potential for sustainability of the organization (through use of stability or sustainability indicators)
- tax-exemption requirements in a nation and how they might coincide or compete with those in the United States

Though it may seem as if the answers to these questions are already known, especially if the organization is familiar, the process bears repeating to ensure that those who receive endowments are prepared to receive and manage them.

In some instances, when no credible NGO exists, a new organization may be formed to receive endowment funds from USAID. However, endowing a new organization brings with it increased risk and, in most cases, an increased need for oversight and monitoring to a level that goes beyond the spirit of an endowment.

Therefore, if the recipient is new, it should be required to be fully operational for a specified period (perhaps two years prior to receipt of endowment funds). Other institutions, such as the Ford Foundation, use a list of IO criteria, or test points, when assessing the endowment worthiness of an organization. USAID could test a new organization's endowment worthiness by giving it a grant for a small, short-term activity. Major problems with financial management or leadership are apt to emerge in this period, and this test would serve as a good indication of the organization's ability to handle an endowment.

However, if USAID chooses to endow a new organization, it must be prepared for the additional time, technical assistance, and oversight that is likely to be required.

RECIPIENT ORGANIZATIONS MUST BE PREPARED: Many organizations require assistance in adjusting their systems and processes to handle an endowment. In the case of a new organization, entire systems of financial management, planning, and governance must be established. In the case of pre-established groups, additional levels of financial management and control often need to be implemented. To ensure that all required systems are implemented by the recipient organization, USAID should dedicate a small portion of funds for this purpose within every endowment grant agreement. The exact amount will depend on the level of sophistication of the proposed recipient. For those groups who had or used funds for this purpose, the endowment process seemed to run more smoothly.

In many cases, this is already being done. Such an amount will help ensure that all needed systems are in place and that the endowment starts off right.

ENDOWMENT RECIPIENT ORGANIZATIONS MUST BE HELD ACCOUNTABLE: Managing an endowment takes time and is an ongoing process. A well-run, savvy organization can change. New managers, new systems, or even a changing national or global context can have an impact on the success of an organization and its endowment. Therefore, each recipient organization and its endowment should be evaluated at least every other year during the oversight period by an independent individual or group not affiliated with the recipient organization and well versed in endowments, PD-21, and USAID.

It is important to note that many grant agreements have a similar requirement currently in place. However, few of these required evaluations actually take place. Those that have taken place have revealed areas of concern and made recommendations for improvement. The results of these regular evaluations will help USAID monitor progress and allow it to recommend changes prior to the end of USAID's oversight period.

GOVERNANCE

GOVERNANCE SHOULD BE VALUED: Governance is often an undervalued concept in organizational development. Though all endowment recipient organizations have a board or governance structure, not all are active or attuned to the requirements or responsibilities of an endowment. USAID representatives should know the role of the board in the recipient organization and discuss how that role might change following approval or implementation of an endowment. USAID should work with the recipient organization in cases where the board is not active or attuned to the endowment to ensure that it is properly managed and not neglected.

DECISION-MAKING SHOULD BE CLEAR: The grant agreement or annual investment-planning documents should delineate the decision-making process within the organizations to ensure accountability regarding the investment of funds.

ENDOWMENT KNOWLEDGE IS KEY: Many boards primarily comprise technical specialists, unaware of the concepts of endowments and the basics of investing. USAID should require all boards to participate in an endowment/investing workshop or other training to learn key concepts.

INTERNAL FINANCIAL MANAGEMENT

UNDERSTAND THE OPTIONS: Recipients need to understand the internal financial management options of trusts, finance committees, and independent financial managers and work with USAID to select the appropriate option. This might include an assessment of internal financial management capabilities and investment knowledge.

ADJUST FINANCIAL MANAGEMENT OVER TIME: If the selected internal financial management system is a trust in which the beneficiary organization has limited decision-making and financial management responsibilities, design a plan in which such responsibilities can increase if appropriate. If the beneficiary organization is institutionally strengthened by the endowment funds and has abilities to take on some financial management and decision-making, this option should be pursued.

CATEGORY TWO: ENDOWMENT FUNDS

TYPES OF ENDOWMENTS

As the goals of each endowment are different, the proposed recipient organizations should not be mandated to use a specific type of endowment. However, not all staff at USAID understand the different types of endowments.

CLARIFY ENDOWMENT TYPES: *PD-21* should define and discuss the two types of endowments, evergreen and sinking, and the characteristics of each. Currently, *PD-21* addresses in general terms the types of endowments in a discussion on the life of the endowment. Though it does not espouse one over another, it seems to indicate that a sinking fund is appropriate in some cases and should be considered. This might be prompted by the fact that evergreen endowments seem to be the default type, at least in those analyzed for this review.

USAID should make sure that the endowment proposal has a justification for one type of endowment through responses to the following questions:

- What is the role of USAID in a given nation?

- If a country graduates, is USAID funding still required in a sector or with a specific organization? If so, for how long? Should the activity or organization last forever, should USAID ensure the future of the activity or organization, or should the burden be shared with the recipient organization?

ENDOWMENT OBJECTIVES

ARTICULATE THE OBJECTIVES: Endowments are not designed to fulfill broad development objectives. Rather, they strive to achieve an intermediate result, such as sustainability of an organization or development of a sector. Nonetheless, the organization should articulate the objectives of the endowment — the broad development objective under which it works and the intermediate objectives that it hopes to achieve.

MEASURE PROGRESS: Benchmarks toward the intermediate result should be articulated to allow USAID to measure the progress of the organization as a result of the endowment. Benchmarks might include increased cost recovery, a diversified funding base, or increased numbers of groups devoted to an activity or sector. Benchmarks or indicators against a development objective might also be used. However, the nature of the endowment might make these indicators difficult to achieve since progress or results are often slow to emerge.

USE OF FUNDS

DEFINE THE USE OF FUNDS: Each use of endowment funds has a different time span and capital requirement. This report outlined three of the most common uses of endowment funds: operating expenses, grant-making, and specific project or product expenses. It is important that the use of the endowment funds is articulated and supported in the proposal and grant agreement.

REGULATE THE USE: When USAID disbursed funds to a recipient organization, it agreed to a spending plan. In some instances, the spending rate was accelerated. In others, it was halted or slowed as USAID provided additional grant funds or expenses were covered in other ways. The result of a slowed spending plan is growth of the endowment's principal. However, it might mean that the recipient organization is waiting until USAID oversight is completed and restrictions on spending patterns are lifted. Approval by USAID to delay use of funds should be required.

SIZE AND COST

QUANTIFY THE NEED: Recipient organizations should know the full costs of the program or activity they hope to support with the endowment. Financial projections and planning will help the organization understand the cost of the new activity (see Appendix E). However, establishing and maintaining an endowment is costly. Typical expenses include labor at USAID and at the recipient organization, time, legal fees, and other administrative expenses. A recipient organization should use its projections to estimate the financial need on an annual basis. It can then work backward to estimate the size of the desired endowment. USAID should review this estimate to evaluate whether the funds available are sufficient and whether the endowment is viable.

ESTABLISH REALISTIC ENDOWMENT SIZES: Given the multiple costs and length of time to establish an endowment (often 18 to 24 months), guidelines for a minimum endowment size should be included in *PD-21*. This amount would vary, based on the type and use of the funds. In this way, a sinking fund might have a different recommended size range than an evergreen endowment. For example, \$1 million is appropriate if a token amount is all that is necessary or if USAID funds are part of a much larger endowment that includes funds from several sources.

However, \$1 million is too low if a grant program to build a sector is the intended goal of the endowment. In these instances, \$5 million to \$10 million should be considered. Only with endowments of this size will sufficient income be earned to cover inflation, asset management fees, operating costs at the recipient organization, and implementation of programs (such as grants). A set amount, either minimum or maximum, is not recommended. Rather, *PD-21* should offer guidelines and a rationale regarding the proposed size of an endowment, taking into account the time and costs involved in the process.

INVESTMENT MANAGEMENT

EXPAND KNOWLEDGE OF INVESTMENTS: Generally, there is a steep learning curve for USAID representatives and recipient organizations with regard to investing. Recipient organizations and USAID representatives should be provided with a packet of basic information on investing, such as those issued by the Ford Foundation (*Investment Management for Endowed Institutions* and *A Primer for Endowment Grantmakers*), or the USAID-funded publication issued by the PROFIT project (*Endowments as a Tool for Financial Sustainability: A Manual for NGOs*). These publications offer an overview of the endowment mechanism and the major aspects of investing, and will allow for a reasonable level of knowledge among concerned parties. Reviewing these materials will not replace the need for an asset manager or for decision-makers skilled in finance and investing but will help ensure a general understanding by all involved in the process. Review of these materials could be a CP, required for potential recipient organizations prior to receipt of funds.

EXPAND KNOWLEDGE OF ASSET MANAGEMENT: USAID representatives should be aware of the options in asset management (active, passive, big firms, small firms, and the like) to ensure that when they approve the selection of the asset management firm, they are appropriately informed.

- **Open the selection process:** When USAID is the primary or exclusive donor to an endowment fund, it should require that selection of the asset management firm take place through an open and competitive process. Though creating a pre-defined short list of bidders is more time-efficient, it often neglects firms specializing in non-profit investing. A full and open competition with no pre-defined list will allow a varied pool of potential asset managers. This may not be practical, however, in a joint-funding relationship when the other party has a longstanding relationship with a specific firm.
- **Monitor asset managers:** The recipient organization must monitor the activities of the asset manager. The asset managers should not be granted complete discretion to buy and sell securities without the approval of the people responsible for the endowment within the organization. Asset managers do not necessarily understand the financial needs or the entire financial situation of the organization. Furthermore, with full discretionary powers, they may tend to favor stocks over fixed assets and be tempted to buy and sell frequently to increase their own profits.

PORTFOLIO MANAGEMENT

OUTLINE INVESTMENT OPTIONS: *PD-21* should further clarify (or at least outline) some of the typical investment instruments. Though it mentions the acceptability of interest-bearing accounts and equity investments, it does not offer details regarding equity versus fixed-income and long- versus short-term investment options.

DEFINE INVESTMENT GOALS OF THE PORTFOLIO: The investment policies of a recipient organization should be required to include certain items regarding goals of investing, proposed split of the portfolio mix, and acceptable/forbidden instruments.

DEFINE TARGET INVESTMENT RETURNS: The endowment should target rates of return that are based on, and tied to, benchmarks consistent with the portfolio mix. These might include Moody's or Standard & Poor's. Target rates of return should not be defined devoid of market conditions.

ENDOWMENT PERFORMANCE

MONITOR AND REVIEW THE PORTFOLIO'S PERFORMANCE: *PD-21* should require a regular performance review of endowment funds, by both USAID and the recipient organization. The recipient organization also should be required to present a discussion of the endowment investment's performance in the annual report for USAID.

DEFINE APPROPRIATE INVESTMENT RISK: *PD-21* should require that investments or performance targets be realistic and not jeopardize the endowment's principal. Though grant agreements often mandate that the principal be preserved (for evergreen endowments) and not threatened by the nature of the investments, establishing this in the endowment guidelines would solidify the point. It also would stress the responsibility of the recipient organization and the risks associated with investing. Should the corpus be threatened or depleted because of risky investments, a potential course of action on the part of USAID should be outlined.

CATEGORY THREE: USAID AND ITS ROLE

GRANT AGREEMENT AND STANDARD PROVISIONS

The grant agreement is USAID's safety net. It is the primary opportunity for USAID, in a legal document, to ensure protection of its assets and interests. A well-designed grant agreement can prevent confusion.

PREPARE AND REFERENCE SAMPLE DOCUMENTS: Sample agreements and other endowment-related documents should be referenced in *PD-21* so that all interested in establishing an endowment have a model to work from.

POST ENDOWMENT-SPECIFIC INFORMATION ON THE USAID INTRANET SITE: The USAID intranet site should include names and contact information for those in GC or OP who are comfortable with the endowment process and especially those skilled in writing endowment grant agreements that can offer advice or assistance when needed.

BE SPECIFIC IN THE GRANT AGREEMENT: The grant agreement should be specific to the context of the recipient organization. It should outline requirements and consequences of non-compliance.

REQUIRE AND UNDERTAKE REGULAR EVALUATIONS: *PD-21* should stress the importance of evaluations and indicate that they must include a review of compliance with the grant agreement.

DEFINE OVERHEAD SPENDING LIMITS: The grant agreement should always specify what percentage of endowment earnings could be used to cover overhead and other associated administrative costs.

CONDITIONS PRECEDENT

Fulfillment of the CPs is the first endowment-specific activity in which USAID can begin to analyze the endowment's potential for success.

EXPAND STANDARD LIST OF CPS: Better articulate tax-exempt and pre-award survey requirements and other universally required items, such as personnel or conflict-of-interest policies.

POST STANDARD LIST OF CPS ON INTRANET: Sample CPs should be listed on the USAID intranet section on endowments. They should include variations based on the history of the organization and its relationship with USAID.

SPECIFY AND ENFORCE TIME FRAME FOR CPS: The grant agreement should articulate a time frame in which the CPs must be fulfilled. Consequences for non-compliance with this deadline also should be delineated.

LEGAL, TAX, AND REGULATORY REQUIREMENTS

Compliance with all tax and regulatory issues is key. USAID does not want to set up a mechanism, endowment or otherwise, that will be detrimental to the financial purposes of any organization. However, this will require additional details and available resources for those in USAID working through these issues with a recipient organization.

ASSESS THE LEGAL ENVIRONMENT: Regional legal advisors (RLAs) and legislative and legal advisors (LEGs) may not have information about the nuances of NGO and non-profit law in a host country. Therefore, the pre-award survey for the endowment should include an analysis of the local legal and regulatory environment related to endowments; NGOs; and the legal, tax, and regulatory requirements. This may involve hiring a local legal expert. The results of the pre-award survey often will dictate specific steps or requirements for the recipient organization in relation to the endowment.

ADDRESS THE TAX-EXEMPTION ISSUES: The USAID intranet and *PD-21* should delineate the major points of the tax-exempt issue, reference any information packets on the topic, and offer names of those within the agency who have successfully worked with a recipient organization to get them through the process. Currently, *PD-21* notes that the recipient organization is ultimately responsible for the tax liabilities stemming from an endowment. It does not dictate obtaining tax-exempt status (though most grant agreements outline this as a CP). If tax-exempt status is required, it should say so in *PD-21*. However, if this is the case, the various tax-exempt options, for example, 501(c)(3), 501(c)(4), and others, must be discussed in greater length.

USAID MONITORING AND OVERSIGHT

PLAN THE ENDOWMENT AND LEARN ABOUT THE RECIPIENT: USAID's monitoring and oversight of the endowment unofficially begins at the planning and proposal stage. During these early steps, USAID can explore opportunities and challenges associated with this potential endowment and understand in greater detail the work of the prospective recipient and its plans for use of the endowment funds.

MAINTAIN USAID/W APPROVAL FOR THE ENDOWMENT: *PD-21* requires that PPC and GC in Washington sign off and approve all endowments before they are sent to the designated Bureau leader for final approval. Though some Mission staff are quite adept in the endowment process and are familiar with *PD-21*, others are not. To minimize USAID's liability and ensure involvement of those in USAID with the most extensive knowledge of endowments and *PD-21*, USAID/W approval should remain a required part of the process. If the time comes that most Missions and technical staff are knowledgeable of, and comfortable with, *PD-21* and endowments, this approval step can be re-evaluated.

MONITOR THE ENDOWMENT ONCE IMPLEMENTED:

Endowments must be monitored to ensure compliance with the grant agreement, the CPs, and the reporting requirements.

- *PD-21* must define the type of management and oversight required with an endowment, as the experiences of those reviewed varies greatly. A statement of work or a job description for an endowment manager can be referred to in *PD-21* and posted on the intranet site.
- *PD-21* and grant agreements require certain types of reporting to USAID during the specified oversight period of the endowment. If USAID is going to request and collect such documents, they should be reviewed with the recipient on an annual basis, at a minimum.
- *PD-21* does not designate a specified oversight period for endowments. Usually it is the grant agreement that details this schedule. To ensure some level of consistency, USAID should delineate parameters or propose oversight terms in *PD-21*. Research indicates that most endowments have either a 5- or 10-year oversight period.

To alleviate concerns regarding limited control for certain endowments, USAID should consider a tiered oversight term structure. For example, endowments over \$5 million might have in-depth oversight for 5 years (similar to oversight for a grant), regular oversight for 10 years, and then post-oversight. If the endowment is under \$5 million, it might have 10 years of regular oversight, then post-oversight. This will ensure closer attention to those endowments of larger value, as well as longer oversight for all endowments. Similar higher levels

of oversight could exist for endowments to new organizations, endowments with newly appropriated funds requiring congressional approval, or endowments when there is no joint funder or trustee. This structure could be presented in *PD-21* as guidelines, noting that the circumstances of each recipient organization will determine the most appropriate oversight structure.

- If an endowment is used as part of a graduation strategy, oversight must take place with the same level of rigor and control as those endowments in presence nations. Presently, oversight for these endowments takes place at USAID/W; because of geographic location and competing priorities, the oversight is often not as rigorous as if it were done at the Mission level.
- *PD-21* and grant agreements should specify under what circumstances the endowment funds could be rolled over and reinvested to grow the corpus. Growing the corpus in the early years of the endowment is usually appropriate, particularly when USAID is providing the funding in segments. If the reinvestment strategy is utilized, the oversight should be adjusted accordingly. USAID needs assurance that this rollover strategy is not merely to allow the oversight period to pass without activity and then permit spending at will in the post-oversight period. Therefore, the oversight should be for a specified period, such as 5 or 10 years, or 2 years from the date of first drawdown and use of funds (either interest or principal), whichever is later.
- When USAID has ex-officio representation in the governance structure of the recipient organization, it is often misunderstood by USAID and the recipient organization. Though not required within *PD-21*, it is recommended as one way to undertake oversight. Many endowment agreements specify this as a requirement. If ex-officio representation is to continue, a sample statement of work or job description should be designed, referred to in *PD-21*, and available for use through the intranet site. This will help clarify the role and prevent too much or too little activity by the individual filling it. Potential candidates for such a role should review the job description and have time to undertake the responsibilities. The job description must include discussion of limits of authority and the relationship between the ex-officio representative and the technical officer.

- Participation in an ex-officio capacity should be discouraged in post-oversight, as the recipient organization is supposed to go out on its own at that point. However, if requested by the recipient organization, ex-officio representation can be considered, based on the specific circumstances and the details of the relationship between USAID and the organization.
- *PD-21* should require analysis of the relationship between the recipient organization and USAID, especially if the organization will serve as an endowment recipient and grant recipient concurrently. This is because the arm's-length nature of oversight is negated if USAID provides the ongoing project or grant with regular and in-depth reports of finances and activities. If other USAID funding is required, either assign a different technical officer to oversee the endowment (to prevent this person from getting caught in non-endowment details), or design an oversight structure that can reconcile the two types.
- USAID/W personnel also should receive regular reports on all endowments where USAID oversight is still in force. Currently all endowment information is retained at the Mission or Regional Bureau level, thereby creating a dearth of information at USAID/W about the endowment as a viable tool. USAID (PPC and Bureaus) should agree on an appropriate level of information to flow back to USAID/W related to an endowment's performance.

RECOURSE AND TERMINATION

CLARIFY TERMINATION TERMS: *PD-21* should further detail the conditions under which termination can take place and the process for it.

IMPLEMENT TERMINATION WARNING PROCESS: *PD-21* and the grant agreement should specify steps or warnings on the road to termination. For example, a letter of warning can be sent to the recipient organization if USAID is concerned about such issues as mismanagement, adverse audit findings, or dissolution. The letter can outline recommended steps and a timeline for improvement. However, if termination were sought, it would not be a surprise, as documents leading up to termination would be on file.

USAID AND ENDOWMENTS

INFORMATION ON ENDOWMENTS IS KEY: Information sharing is key to the success of the endowment mechanism.

- Update and revamp the intranet site on endowments with sample documents, job descriptions, and names of those willing to assist in the process.
- Design and offer an in-house training on "Endowments IOI" and "Endowments With USAID." Both can include sharing of experiences by those who have been through the process. A how-to guide could be a deliverable of this workshop.

USAID has the opportunity to be a pioneer in the donor world for the use and value of endowments. Given the several years of experience and multiple cases that serve as points of analysis, USAID can share its experience. The agency could sponsor a workshop or seminar for donors, foundations, and even corporations on the endowment mechanism. Not only would this offer alternatives for organizations seeking funds, but it might also foster collaborations between funders, in which USAID's funds could leverage new funds. At present, donors are skeptical about endowments, but USAID can demonstrate a return on investment within this mechanism and perhaps build new partnerships as a result.

ASSISTANCE WITH ENDOWMENTS IS NEEDED: A well-managed and monitored endowment takes time and knowledge. USAID's resources are limited, and many within the agency are not fully familiar with this mechanism. Individuals or firms can be called upon to assist with the various stages of the endowment process. Scopes of work should be designed and distributed on the intranet or in the how-to guide for the following stages that might require the assistance of outside consultants or firms:

1. external assessment of the endowment worthiness (similar to a pre-award survey)
2. institutional development in such areas as governance, financial management, and planning
3. endowment proposal writing and accompanying financial projections to determine need, type, size, and use

4. gathering and filing of documentation related to tax-exempt status
5. investment of the endowment funds, including writing the investment policy and hiring the asset manager
6. filing the first set of reports: annual report, annual plan, income and expense projections, and the like
7. external evaluations on a bi-annual basis, including recommendations for improvement or points of concern within the deliverable
8. assistance in the shift to post-oversight: design of an endowment management plan and maintenance of financial controls and accountability

At present, some recipient organizations hire consultants to assist in the endowment process. However, many of those hired appeared to be technical experts in a sector, as opposed to experts in endowments or investing. Therefore, a mechanism through which USAID/W, Missions, and/or potential recipient organizations can access experts would make sense.

One option would be to use a pre-existing contract mechanism in which these services could be solicited. A quick review reveals that the new capable partners (CAP) initiative might be an appropriate choice. Another option would be to design an endowment indefinite quantity contract (IQC) where, for a set period of time (five years perhaps), select individuals or firms would be tapped to assist USAID and the recipient organization through the endowment process, from design to implementation and management. As part of this process, USAID could approve a set of global standards for endowment worthiness, evaluation, and post-oversight planning. These broad-based standards could be used by all participating in this mechanism and applied to each endowment. In this way, as Mission representatives change or endowment managers move on, the standards and requirements would remain.

Appendix A

APPENDIX A

SCOPE OF WORK FOR A REVIEW OF USAID'S ENDOWMENTS FUNDED WITH APPROPRIATED DOLLARS

PURPOSE

USAID developed guidelines for funding dollar-appropriated endowments in 1994. Since that time, USAID has not conducted any reviews to determine the effectiveness of the guidelines, or to evaluate the operational experience of the organizations receiving dollar-appropriated endowments.

The purpose of this activity is to assess USAID's experience with dollar-appropriated endowments authorized under *PD-21*. The review should focus on several critical management and operational considerations, including the effectiveness of the endowed organization in meeting its objectives, the management of the portfolio and disbursement of funds, the amount of funds available for grant-making activities, the ability of USAID and private-sector entities to monitor the endowed organization, and lessons learned that can be applied to future endowments. USAID will use the findings and lessons learned to update *PD-21* as appropriate.

BACKGROUND

Until the mid-1990s, USAID funded virtually all of its endowments with local currency. The track record of these endowments is limited. Moreover, when these endowments were designed and approved, well over a decade ago, there were no performance and oversight requirements. Thus, USAID has not been able to derive any "lessons" from the operational experience of these local-currency endowments.

In recent years, most of the USAID-funded endowments to private-sector organizations have been with appropriated dollars. During the 1994–2000 period, USAID/W had approved 15 endowments. One endowment has been terminated for failing to meet its operational objectives.

The first group of approved appropriated-dollar endowments attempted to build local capacity to address environmental problems. As Bureaus and Missions learned more about endowments, it became readily apparent that endowments could be applied to the full range of sectors encompassing USAID's bilateral assistance activities. USAID now has endowments in the health, education, democracy/good governance, and environmental sectors, with several being considered for economic growth. The vast majority of the approved endowments are in the health and environment sectors.

So far, it seems that the endowments are easier to design in the health sector. The reason is that USAID Missions have had well-established programs with NGOs (with a proven track record) that are attempting to move toward financial sustainability. The investment proceeds from an endowment allow them to reach this goal.

For the non-health sectors, one of the major tasks in designing an endowment is finding an NGO with a proven track record. It is often the case that USAID (e.g., the Bureau or Mission) must build an organization to be the recipient of the endowment. This is one of the major design problems, and it usually delays the start of an endowment.

When planning an endowment, USAID Bureaus and Missions often commit significant resources and time in the design of the organization, scope of the program, and the management of the investment portfolio. USAID monitoring of the endowment, once it is approved, is an important part of the oversight process, as well as a way to capture lessons learned for planning future endowments. However, little is known about the operations and effectiveness of most of the endowments approved to date. This makes it difficult to determine the soundness of the endowment mechanism.

STATEMENT OF WORK

In order to determine the effectiveness of the endowment mechanism, and to integrate these experiences into *PD-21*, this review analyzes the operations of a representative set of appropriated-dollar endowments.

The review incorporates input from USAID Bureaus/Missions and the endowed organizations. The following questions are part of the review of each of the selected endowments.

OVERSIGHT

- What is the extent of USAID oversight?
- Did the Mission end USAID oversight, and what procedures were used to arrive at this decision?
- What documents are available publicly to monitor the operations of the endowment?
- What does the Bureau/Mission do to monitor the endowment?
- Has the organization been conducting annual audits?
- Has the Bureau/Mission reviewed the audits? Has any feedback been given to the endowed organization?
- What reporting mechanisms are provided for in the endowments, and are they adequate?

OPERATIONS

- Has the endowed organization consulted with USAID on specific operational problems? How were they resolved?
- Is there any information to determine whether the organization is following its charter and achieving its stated objectives?
- What are the major startup problems faced by the organization? How have they been resolved?
- Does the country's institutional and regulatory framework allow the endowed organization to operate without constraints?
- Did the organization experience any problems in obtaining 501(c)(3) tax status?

- What is the organization's experience on leveraging funds from other donors?
- What are the management costs, and what percentage of the endowment earnings are spent on administrative and operational costs?

PORTFOLIO MANAGEMENT

- What is the financial status of the investment portfolio?
- Who manages the investment portfolio?
- What process was used to hire the portfolio manager?
- How is the portfolio manager evaluated each year?
- How much of the investment income is used to provide grants to fulfill the organization's mandate?
- Has the organization been filing tax returns with the US Government?
- How have the rates of return compared with standard measures of stock/portfolio performance?

POLICY ISSUES

- Are there any outstanding policy or legal issues that should be addressed in an update to *PD-21*?
- What are the major lessons learned from the operations of the endowment organizations?
- Does USAID need to consider additional issues in the design of endowments?
- Are there any additional suggestions to improve USAID's post-presence oversight?
- Does the country's institutional and regulatory framework allow the endowed organization to operate without constraints?
- Is the rationale for the endowment still valid?

LEVEL OF EFFORT

USAID will contract with a consulting/research organization to undertake the review and prepare a final report. Within USAID, Bureaus will establish a core team to coordinate the work of the contractor.

The USAID core team will

- refine and finalize the proposed scope of work and the schedule, which includes the endowments to be reviewed
- agree on a common methodology for the review
- obtain consensus for the review from their respective organizations and involve other members as appropriate
- facilitate input from the other USAID personnel at the Mission level
- arrange visits to Missions and the endowed organizations in their countries
- arrange for joint Bureau funding of the review

The contractor will

- provide comments on the scope of work and recommend a methodology to the USAID team
- develop/refine questionnaires and other instruments to facilitate the review of the selected endowed organizations using the specified set of questions
- monitor responses and compile, tabulate, and organize information for review by the core team, as appropriate
- prepare the final report, which shall include a review of the endowed organizations, an analysis of the major problems encountered by these organizations, a synthesis of the funding and lessons learned, and suggested recommendations for improving the endowment design and oversight process (the core team will share responsibility for editing and providing comments)
- assist in organizing a presentation workshop, if applicable

DATA SOURCES

The core team will develop a list of relevant documents to review and incorporate into the final report, including, but not limited to, the current grant agreement documentation, the approved endowment proposals, and annual audits and evaluations.

Appendix B

APPENDIX B

ENDOWMENT ASSESSMENT

Please note that many of these questions will be answered in the following documents:

- Endowment proposal
- Cooperative agreement (CA) between USAID and the recipient organization
- Asset management agreement between organization and asset manager

Copies of these documents would be most useful in completing our assignment and should be obtained if possible. Copies of external evaluations, audit reports, and/or asset management reports, including a disbursement schedule, are also most useful.

SECTION I: GENERAL INFORMATION AND BACKGROUND

1. Name of endowment/recipient organization:
2. Country:
3. Sector:
4. Year endowment established:
5. Amount of endowment and source of funds:
6. Was the recipient a pre-existing organization, or was it formed for the purpose of receipt of the endowment funds?
7. Please describe the endowment specifics, including its type (sinking/evergreen), the term, the fund sources, origin of funds, the schedule of deposits (and conditions if outlined), and so on:
8. Purpose of endowment (as specific as possible, i.e., grant-making mechanism, financial sustainability):
9. Are the organization and its endowment considered independent of other NGOs?

10. Are the organization and its endowment considered independent of the government?

Based on the cooperative agreement between USAID and the recipient organization, please answer the following:

1. Describe the relationship between the NGO and the government.
2. Describe the relationship between USAID and the organization prior to and during the endowment.
3. Who is the USAID point of contact for the purposes of the endowment?
4. What conditions did USAID require as precedent for the endowment?
5. What conditions did USAID require to maintain the endowment?
6. Under what conditions could USAID terminate the endowment?
7. Describe USAID's oversight terms and period for the endowment (if any), including information regarding regular reporting, audits, evaluations, governance, the withdrawal of funds, the investment policies, and so on.
8. Please describe any restrictions that USAID has placed on usage of the interest or principal of the endowment funds.
9. As part of the establishment of the endowment, did USAID require ongoing relationships between the recipient and a CA for management and institutional development? If so, identify the organization and outline the specifics of the relationship.

SECTION II: ENDOWMENT MANAGEMENT

1. Does the organization utilize intermediary financial managers or custodians for the endowment? If so, provide names of firms, contact information, and roles/responsibilities of each firm:
2. Please describe the process and criteria used for selection of management/custodian firm(s):

3. Once selected, did the organization and the asset manager sign a management agreement outlining management of funds? If so, please obtain a copy. Please outline the major points of this agreement, including fund withdrawal, reporting, investing, and evaluation.
4. Describe the type and frequency of communications between financial managers and the organization, including regular reports, meetings, recommendations, and so forth.
5. Does the financial manager comply with the requirements of the endowment as outlined in the CA? How is this guaranteed? What consequences are there for lack of compliance?
6. In general, how is performance of the asset managers evaluated (if at all)?
7. Who has authority to issue/use either interest or principal funds that are disbursed?
8. How does the organization/recipient manage the endowment? In the response, please describe the role of the board of directors of the organization, the investment and/or finance committee (if one exists), and internal decision-making or management of the endowment.
9. Does the recipient organization comply with the requirements of the endowment as outlined in the CA? How is such compliance ensured? Do monitoring and evaluation processes exist to ensure compliance? Are there consequences for lack of compliance?
2. Describe the relative amount of risk and desired rate of return for investment of endowment funds and the process used to define appropriate levels of risk.
3. Describe the performance of the endowment funds. Over time, has the endowment gained or lost money? How much? How has this performance affected investment and portfolio composition decisions? How is performance of the endowment funds measured — against benchmarks? What types? Market-driven benchmarks? Internal benchmarks?
4. Describe the disbursement and use of the income from the endowment funds. How is the interest on the endowment disbursed — monthly, quarterly, or annually? How is the interest used?
5. Describe the disbursement and use of the principal of the endowment funds. What is the disbursement schedule? How can the principal be used?
6. Are there restrictions on usage and/or amount of either the interest or the principal in the terms of the CA? And if so, what are they?
7. Are there restrictions on usage of either the interest or the principal outlined in other organizational documents?
8. How is the endowment protected from a loss of nominal value?

SECTION III: THE PORTFOLIO AND ITS PERFORMANCE

1. Describe the investment portfolio for the endowment. This description should include a discussion regarding the general percentages of equity versus fixed income as outlined in the investment policies. It should also indicate how these percentages or the split may have changed over time and if there were specific reasons (internal or external) for such changes. Please also outline the type of equity and fixed income (e.g., gold; real estate investment trusts, REITs; grade of stocks).

SECTION IV: EVALUATION

1. Describe how the endowment has helped achieve the goals for which it was originally established.
2. What is the process for evaluating use of the endowment for the purpose for which it was conceived (i.e., is it accomplishing what it set out to do)?
3. Has the endowment been externally evaluated? If so, by whom and when?
4. Were the results published, and if so, what is the name of the report? *Obtain a copy.*

5. Has the organization been audited? If so, when was the last financial audit?
6. Have the endowment funds been audited? If so, when? *Obtain a copy of most recent report if possible.*
7. Describe how the existence of the endowment has impacted the planning or long-term visioning of the organization, including its sustainability, if at all.
8. Describe what internal institutional changes (e.g., human resources) took place, if any, upon receipt of the endowment to ensure its proper management.
9. Does the recipient consider the endowment useful? Successful? In what ways?
10. What are the challenges to the organization in terms of the endowment and its management?
11. What, if anything, would the organization wish to do differently in terms of the endowment?
12. If the endowment is a sinking fund, how does the organization intend to replace the influx of funds from this source when it runs out? Through another endowment or grant? From whom?
6. What are some of the lessons learned in terms of the process that could include recommended adjustments to streamline or facilitate the use of endowments?
7. Are there additional people you would recommend that we contact to learn more about the history and process of implementing the endowment?

SECTION V: BACKGROUND AND RESOURCES

1. How long was the process to obtain the endowment?
2. Please approximate how many staff hours went into preparing for and solidifying the endowment.
3. Approximately, how much money did it cost the organization to obtain and implement the endowment?
4. Was the process difficult and/or cumbersome? If so, in what ways? How could it be improved?
5. What were some of the challenges to the process of implementing the endowment? Were they internal or external?

Appendix C

APPENDIX C

ENDOWMENTS CONSIDERED FOR INCLUSION IN THE REVIEW

Table C1. List of all endowments considered

Number	Country	Name/Organization
1	Armenia	American University of Armenia (AUA)
2	Armenia	Millennium Armenian Children's Fund/Ani and Narod Memorial Fund (MACF)
3	Balkans region	Trust for Civil Society in Central and Eastern Europe (CSCEE)
4	Baltics	Baltic–American Partnership Fund (BAPF)
5	Bangladesh	International Center For Diarrhoeal Disease Research (ICDDR/B)
6	Bhutan	Trust Fund for Environmental Conservation (FEC)
7	Bolivia	Asociación Protección a la Salud (PROSALUD)
8	Bolivia	Fund for Nature and the Environment (FNE)
9	Bulgaria	American University of Bulgaria (AUBG)
10	Global	Cooperative for Assistance and Relief Everywhere — Reproductive Health Trust Fund (CARE)
11	Colombia	Fund for Family Planning in Latin America (PROFAMILIA)
12	Costa Rica	Arias Foundation for Peace and Human Progress (ARIAS)
13	Costa Rica	Fundex/Coalition for Development Initiatives (FUNDEX)
14	Ecuador	Centro Médico de Orientación y Planificación Familiar (CEMOPLAF)
15	Ecuador	Asociación Pro Bienestar de la Familia Ecuatoriana (APROFE)
16	Ecuador	Fund for Agriculture
17	Egypt	Binational Fulbright Commission
18	Egypt	Egyptian Center for Economic Studies (ECES)
19	Gaza/West Bank	Education
20	Ghana	Ghana Heritage Conservation Trust (GHCT)
21	Ghana	Ghana Social Marketing Foundation (GSMF)
22	Global	Transparency International–Global Corruption (TI–GC)
23	Honduras	Centro Asesor para el Desarrollo de los Recursos Humanos/Advisory Council for Human Resources (CADERH)
24	Honduras	Fundación Vida/Foundation for Environment and Development (VIDA)
25	Honduras	Institute for Agriculture/Honduran Foundation for Agricultural Research (HFAR)
26	Indonesia	Indonesia Biodiversity Foundation (KEHATI)
27	Global	International Planned Parenthood Federation/Western Hemispheric Region—Endowment Fund for Sustainability (IPPF/EFS)
28	Jordan	American Center for Oriental Research (ACOR)
29	Madagascar	MEENS/NEEF/ TANY MEVA/ ANGAP/ EPIQ
30	Mexico	Mexico Fund for the Conservation of Nature (FMCN)

Table C1. List of all endowments considered (continued)

Number	Country	Name/Organization
31	Nepal	National Social Welfare Association (NSWA)
32	Panama	Ecological Trust Fund for Fundación Natura (FIDECO)
33	Peru	Fund for Nature PROFONANPE (PROFONAPE)
34	Philippines	Foundation for Philippine Environment (FPE)
35	Poland	Polish American Freedom Foundation (PAFF)
36	South Africa	African Center for Constructive Resolution of Disputes (ACCORD)
37	South Africa	Ron Brown Trust (RBT)
38	South Africa	Amy Biehl Foundation (ABF)
39	South Eastern Europe	Endowment Fund for Local Initiatives for Tolerance and Sustainability (LIFTS)
40	Sri Lanka	Environment
41	Swaziland	Swazi Business Growth Trust (SBGT)
42	Thailand	Kenan Institute Asia (KIASIA)
43	Zimbabwe	Zimbabwe American Development Foundation (ZADF)

Appendix D

APPENDIX D

PD-21 COMPLIANCE QUESTIONNAIRE

Table D1. Questionnaire

	Yes	No
1. Are the endowment fund and the recipient organization independent from USAID?		
2. Is the endowment's purpose to maintain the activities of a private, non-profit institution?		
3. Is the recipient a private, non-profit organization?		
4. Is the endowment's purpose consistent with USAID's authorizing legislation?		
5. Are PPC and GC included in all reviews?		
6. Are issues that are set forth in <i>PD-21</i> , starting on page 4 (i.e., Consistency with USAID strategy, <i>PD-21</i> -approved endowment objectives, recipient NGO characteristics, recipient financial participation, financial management considerations, legal-regulatory environment) specifically considered during the approval process — and are they documented?		
7. Is the endowment proposal consistent with the established objectives and approved strategies for the country, region, or sector in which funds are to be expended?		
8. Is the endowment directed at achieving objectives not attainable through traditional assistance modes?		
9. Is the endowment objective one or more of the six possible objectives listed on page 4 of <i>PD-21</i> ?		
10. Has the Bureau/Mission been assured that the endowment's objective(s) is (are) achievable under current circumstances?		
11. Has the Bureau/Mission determined that an endowment is more cost-effective than multi-year support of the organization through technical assistance and institutional and project support?		
12. Has the Bureau/Mission determined that benefits to be gained by establishing the endowment outweigh the benefits of alternative uses of program funds?		
13. Is the recipient an NGO (in the sense that the government does not control the organization)?		
14. Is the recipient organization a registered PVO, or has it met the pre-award survey requirements designed to assure funds accountability?		
15. Does the organization require a high degree of monitoring or oversight? (If it does, it may mean that an endowment is not an appropriate mechanism for providing assistance in the absence of prior capacity-building grants.)		
16. Has financial participation on the part of the recipient (preferably 25 percent) been obtained, or does the NGO provide a critical, non-substitutable service in achieving bilateral assistance objectives?		
17. Will USAID/US Government not actively participate in the implementation of program activities?		
18. Has the Bureau/Mission assured itself that the endowment beneficiary can adequately implement programs and manage/account for expended funds without detailed oversight by USAID?		
19. If the organization has been determined, via pre-award survey, to have inadequate financial controls, have controls been built into the program design?		
20. Will the return generated by the endowment, together with other available resources, be adequate to support the beneficiary organization's program?		
21. Have possibilities for misuse of funds been minimized?		
22. Are funds invested in financial instruments offered in the United States through a US-based financial intermediary?		
23. Will a small amount of funds (needed for current local operating expenses) be held locally — probably in an interest-bearing account?		
24. Were conflict-of-interest issues carefully treated at the design stage?		

Table D1. Questionnaire (continued)

		Yes	No
25.	If an endowment trustee is to be used, is the trustee of US nationality and/or located in the United States and regulated by US laws?		
26.	If the endowment trustee is to be a bank, is the trustee not affiliated with any of the beneficiary organization's board members?		
27.	Have disadvantages of a trustee arrangement already been considered (including difficulties of finding a suitable trustee for a new organization, excess conservativeness of banks where banks are trustees, and the fact that a trust agreement may limit the beneficiary's ability to establish its own track record in funds management?)		
28.	Are endowment funds held in a separate account (or has a waiver been obtained by PPC)?		
29.	Are endowment fund investments sound and prudent, not highly speculative?		
30.	If the endowment is a sinking fund, are funds not drawn down too rapidly so as to avoid the perception that this is a mere advance of funds?		
31.	Does the endowment cover a period of at least 10 to 15 years?		
32.	Were financial plans, including the projection for returns and circumstances under which drawdown of principle were permitted, reviewed by USAID prior to approval of funding?		
33.	Were both US and host country tax issues thoroughly explored prior to approval of the endowment?		
34.	Was local legal counsel consulted early in the process?		
35.	Was a full understanding of local legal and tax issues obtained?		
36.	Is the local legal environment suitable?		
37.	Have arrangements been made to monitor the endowment for 5 to 10 years?		
38.	Has oversight been arranged (limited if the organization has good track record; more and longer oversight if the organization is new)?		
39.	Is USAID participation on the board of directors limited to an ex-officio, non-voting capacity?		
40.	Is the involvement in approval of the board of directors limited to approval of first board and replacement mechanism? (Approval of replacement directors not allowed?)		
41.	Does USAID not have the right to approve subgrants?		

Appendix E

APPENDIX E

ENDOWMENT SIZE/COST WORKSHEET

Determining the size and costs to establish and implement an endowment are critical keys to its success. Only through such a process can the recipient organization and USAID be assured that the size is appropriate to achieve the desired results.

Estimated cost to setup endowment: \$75,000

- Cost includes USAID and recipient organization's time, travel, legal fees and filings, and administrative expenses.

Estimated cost to maintain endowment: \$10,000 annually

- Cost includes USAID and recipient organization's time, asset management fees, and other administrative expenses.

Estimated inflation: 3 percent

- Three percent (or actual inflation rate) of interest earned must be recapitalized to ensure maintenance of the real value of the endowment.

Estimated range of returns: 5 to 8 percent

- This amount is net of inflation and associated asset management fees.

Potential cost to implement endowment programs: Variable

- There are programmatic costs associated with implementing the endowment activities. These are variable, based on the activities the endowment and the recipient organization intend to undertake, but should not be overlooked.

Key questions:

- What is the endowment's purpose (grants, operational costs, and so on)?
- What are the costs?
- What is the anticipated return?
- What size should the endowment be?

The following example demonstrates how using the estimates provided above can help USAID and a potential recipient organization calculate the costs and appropriate size of an endowment.

Endowment size example

Recipient organization X wants an endowment. They hope to use the income generated from the endowment to implement a grant program for specific activities within their nation. The recipient organization and USAID are considering a \$1 million amount for this endowment. Is this sufficient?

Step 1: Calculate annual return

Annual return is the amount that the endowment will earn for the organization on an annual basis. It is calculated as follows:

$$\begin{aligned} & \text{total endowment amount} \times \\ & \text{annual rate of return (D)} = \text{annual return} \\ & \$1,000,000 \times 5 \text{ percent} = \$50,000 \end{aligned}$$

Step 2: Protect real value through recapitalization

Protecting the real value of the endowment requires an amount recapitalized that is equal to the inflation rate.

$$\begin{aligned} & \text{annual return} - \text{inflation(C)} = \text{available return} \\ & \$50,000 - 3 \text{ percent} = \$48,500 \end{aligned}$$

Step 3: Cover costs associated with the endowment

There are two sets of costs associated with an endowment — costs to establish and costs to maintain. Costs to establish are often one large lump sum that is not covered by the earnings from the endowment on an annual basis. These costs are best accounted for through an amortization process. Through this process the total costs of establishing an endowment are spread over a five-year period, that is, 20 percent is calculated as costs annually.

$$\text{available return} - \text{endowment costs (A+B)} = \\ \text{adjusted available return}$$

In this example, endowment costs include 20 percent of the total costs to establish the endowment and the annual costs to maintain the endowment.

$$\$48,500 - (\$10,000 + \$15,000) = \$23,500$$

Step 4: Account for costs of endowment programs/activities

Though this is a variable amount, it is important for the recipient organization to calculate how much it will cost to implement the programs that the endowment funds.

$$\text{adjusted available return} - \\ \text{cost to implement endowment programs (E)} \\ = \text{available endowment program funds}$$

$$\$23,500 - \$15,000 = \$8,500$$

CONCLUSION

In the case of recipient organization X that wants to implement a grant program with a \$1 million endowment, there would be approximately \$8,500 annually to disburse for activities. If the recipient organization wants more funds available for actual grants, the size of the endowment should be larger.

We therefore recommend that the recipient organization and USAID start by determining the estimated need or desired amount of annual funds for the specific program or intermediate objective. Using this number, the four steps can be reversed to determine the needed size of the endowment.



COMMERCIAL MARKET STRATEGIES
NEW DIRECTIONS IN REPRODUCTIVE HEALTH



FUNDED BY:
US Agency for International Development
USAID Contract No. HRN-C-00-98-00039-00

Commercial Market Strategies Office
1001 G Street NW, Suite 400W
Washington DC, 20001-4545
Telephone: (202) 220-2150
Fax: (202) 220-2189
Web: www.cmsproject.com

**Deloitte
Touche
Tohmatsu**

IN PARTNERSHIP WITH:
Abt Associates Inc.
Population Services International